

# **CALIFORNIA COMMENTARY ON RESTATEMENT OF THE LAW THIRD SURETYSHIP AND GUARANTY**

## **Introduction**

The American Law Institute published the Restatement of the Law Third, Suretyship and Guaranty in 1996 ("Restatement of Suretyship"). The Restatement of Suretyship is the most modern study of the subject. Its text, supplemented by Comments, Illustrations, and Reporter's Notes, provides the best available analysis of law and policy in this field.

While California law on the subject is formally codified, in fact this area of California law is primarily developed and embodied in judicial decisions. The statutory coverage, found in sections 2787 et seq. of the Civil Code, was originally enacted in 1872. It was based on the Field Code, itself based on the common law. This was recognized in Mead v. Sanwa Bank California, 621 Cal. App. 4<sup>th</sup> 561, 71 Cal. Rptr. 2d 625 (1998), the first California appellate case to refer (in footnote 2) to the Restatement of Suretyship ("In 1872, the Legislature codified the common-law rule in the form of Civil Code section 2832,..."). Hence, although to a great extent provided for in statutory text (last significantly subjected to general legislative modification in 1939), modern suretyship law in California is essentially reflected in judicial decisions. Thus, the common law of suretyship continues to be significantly relevant in California.

From shortly after their initial adoption, the Restatements have been an important source of authority and guidance for the California courts. In 1934, the California Supreme Court felt warranted in relaxing a rule stated in one of its prior decisions "because this subject has had thorough consideration by law collaborators as shown by the recent product of the American Law Institute, styled: 'Restatement of the Law, Agency . . .'" Speck v. Wylie, 1 Cal. 2d 625, 627, 36 P.2d 618 (1934).

Five years later, the Supreme Court explained in greater detail the Restatements' position as authority in this state:

Although it is true that the restatement does not constitute a binding authority, considering the circumstances under which it has been drafted, and its purposes, in the absence of a contrary statute or decision in this state, it is entitled to great consideration as an argumentative authority. It purports to accurately reflect the general common law of the United States, and where there is a conflict, to state the general and better rule on any given subject. For these reasons, in the absence of contrary authority in this state, and in view of the soundness of the doctrine announced, we are inclined to and do follow the rule announced in [Restatement of the Law of Trusts] section 155.

Canfield v. Security-First Nat'l Bank, 13 Cal. 2d 1, 30-31, 87 P.2d 830 (1939).

California Court of Appeal decisions have cited Canfield in adopting Restatements as California law. Standard Oil Co. v. Oil, Chemical etc. Int'l Union, 23 Cal. App. 3d 585, 100 Cal. Rptr. 354 (1972) (Rest. Restitution); Hawkins v. Oakland Title Ins. & Guar. Co., 165 Cal. App. 2d 116, 125-26, 331 P. 2d 742 (1958) (Rest. Torts); Karpetian v. Carolan, 83 Cal. App. 2d 344, 348-50, 355, 188 P. 2d 809 (1948) (Rest. Contracts, Rest. Restitution); Scholey v. Steele, 59 Cal. App. 2d 402, 405, 138 P.2d 733 (1943) (Rest. Torts).

More often, modern California decisions have taken for granted the Restatements' role as leading and persuasive authority, citing and following the applicable Restatement section without stopping to explain why it is proper to look to the Restatement as a source of California law. See, e.g., Rosenthal v. Great Western Fin. Securities Corp., 14 Cal. 4th 394, 420-23, 58 Cal. Rptr. 2d 875, 926 P.2d 1061 (1996) (Rest. 2d Contracts); Bily v. Arthur Young & Co., 3 Cal. 4th 370, 408-14, 11 Cal. Rptr. 2d 51, 834 P.2d 745 (1992) (Rest. 2d Torts); Garcia v. Superior Court, 50 Cal. 3d 728, 734-36, 268 Cal. Rptr. 779, 789 P. 2d 960 (1990) (Rest. 2d Torts); Bloom v. Bender, 48 Cal. 2d 793, 798, 800, 313 P. 2d 568 (1957) (Rest. Security).

California has also followed the Restatements in the field of suretyship law. See, e.g., Bloom v. Bender, 48 Cal. 2d 793. This is true even though many legal principles of suretyship law are codified in the Civil Code. With a few exceptions, such as section 2856 (concerning waiver of suretyship defenses), the Civil Code sections on suretyship survive essentially unchanged from their original enactment as part of the 1872 Civil Code.

As the California Supreme Court has explained, the 1872 Civil Code was, in effect, the Restatement of its day, organizing and concisely restating the case and statutory law of that time. Li v. Yellow Cab Co., 13 Cal. 3d 804, 814-15, 119 Cal. Rptr. 858, 532 P.2d 1226 (1975). In enacting this proto-Restatement as the law of California, "it was not the intention of the Legislature to insulate the matters therein expressed from further judicial development; rather it was the intention of the Legislature to announce and formulate existing common law principles and definitions for purposes of orderly and concise presentation and with a distinct view toward continuing judicial evolution." Id., 13 Cal. 3d at 814; see also I. J. Weinrot & Son, Inc. v. Jackson, 40 Cal. 3d 327, 332, 220 Cal. Rptr. 103, 708 P.2d 682 (1985).

The Civil Code was not designed to embody the whole law of private and civil relations, rights, and duties; it is incomplete and partial; and except in those instances where its language clearly and unequivocally discloses an intention to depart from, alter, or abrogate the common-law rule concerning a particular subject matter, a section of the code purporting to embody such doctrine or rule will be construed in light of common-law decisions on the same subject.

Estate of Elizalde, 182 Cal. 427, 433, 188 P. 560 (1920).

The Restatement of Suretyship, like its predecessor, the Restatement of Security, and like the Restatements of other subjects, shows how "common-law decisions on the same subject"

have evolved and hence, like its predecessors, gives California courts valuable guidance in construing the Civil Code in light of modern notions of suretyship law.

Given the importance of certainty and predictability in commercial law, and the importance of uniformity in a national economy, future judicial development of California suretyship law should be powerfully influenced by the Restatement of Suretyship. To facilitate this end and, as a service to the California bench and bar, to provide a convenient comparison of the Restatement of Suretyship with current California law, the UCC Committee has prepared this Report.

This Report has been a project of the Committee carried out over several years. Because it reflects the collective work of many individuals, past as well as current members of the Committee, the Report is not signed by the current Committee membership or by individual contributors.

## Statutory Cross-References

January 25, 2000

The following table cross-references those sections of the California Civil Code dealing with suretyship to corresponding sections of the Restatement of Suretyship. Where there is no direct correspondence between the Civil Code and the Restatement of Suretyship, the table attempts to identify sections or comments to sections of the Restatement of Suretyship that deal with analogous issues, whether or not the Civil Code and Restatement of Suretyship are in agreement on these issues.

**Table**

<b>California Civil Code Section</b>	<b>Topic or Title</b>	<b>Restatement of Suretyship</b>	<b>Topic or Title</b>
§ 2787	Secondary obligors and guarantors; distinction abolished; definitions	§§ 1(1), 2, 15	Scope; Transactions giving rise to suretyship status; Contract creating the secondary obligation; Interpretation of the secondary obligation; Use of particular terms
§ 2788	Secondary obligor without knowledge or consent of principal	§§ 1(3)(d), 2(a), 20	Scope; Transactions giving rise to suretyship status; Contract creating the secondary obligation; When principal obligor is charged with notice of secondary obligation
§ 2792	Consideration	§ 9	Consideration
§ 2793	Writing; signature	§ 11(1)	Statute of frauds
§ 2794	Original obligations not requiring a writing	§ 11(2)-(3)	Statute of frauds
§ 2795	Acceptance of offer; notice	§ 8	When notification of acceptance of the secondary obligation is necessary for the creation of the secondary obligation
§ 2799	Incomplete contract; implied terms	§ 14	Interpretation of the secondary obligation—generally
§ 2800	Guaranty that obligation is good or collectible	§ 15(b)	Interpretation of the secondary obligation; Use of particular terms
§ 2801	Guaranty that obligation is good or collectible; recovery	§§ 50, 15(b)	Effect on secondary obligation of obligee's lack of action to enforce underlying obligation; Interpretation of the secondary

<b>California Civil Code Section</b>	<b>Topic or Title</b>	<b>Restatement of Suretyship</b>	<b>Topic or Title</b>
			obligation; Use of particular terms
§ 2802	Guaranty that obligation is good or collectible; secondary obligor's liability	§ 15(b)(3)	Interpretation of the secondary obligation; Use of particular terms
§ 2806	Suretyship obligation unconditional	§ 1(3)(c)	Scope; Transactions giving rise to suretyship status;
§ 2807	Secondary obligor liability without demand or notice	§ 1(2)	Scope; Transactions giving rise to suretyship status
§ 2808	Secondary obligor upon a conditional obligation; notice of default	N/A	No directly corresponding or analogous section in the Restatement of Suretyship
§ 2809	Secondary obligor's obligation commensurate with principal obligation	§ 1 comments k-l	Scope; Transactions giving rise to suretyship status
§ 2810	Secondary obligor liable notwithstanding mere personal disability of principal—not liable, when	§§ 19(b), 34	Suretyship status—defenses of secondary obligor against obligee; When defenses of principal obligor may be raised by secondary obligor as defenses to secondary obligation
§ 2811	Bonded principal; agreement with secondary obligor; deposit of money and assets	N/A	No directly corresponding or analogous section in the Restatement of Suretyship
§ 2814	Continuing guaranty—defined	§ 16	Continuing guaranty
§ 2815	Continuing guaranty—revocation	§ 16	Continuing guaranty
§ 2819	Alteration of original obligation or remedies	§§ 37, 39(b)(ii), 39(c)(iii), 41, 48	Impairment of suretyship status; Release of underlying obligation; Modification of underlying obligation; Waiver of suretyship defenses—consent
§ 2820	Suspension or impairment of remedy;	N/A	No directly corresponding or analogous section in the

<b>California Civil Code Section</b>	<b>Topic or Title</b>	<b>Restatement of Suretyship</b>	<b>Topic or Title</b>
	creditor's void promise		Restatement of Suretyship
§ 2821	Rescission of agreement altering obligation or impairing remedy	N/A	No directly corresponding or analogous section in the Restatement of Suretyship
§ 2822	Partial satisfaction of obligation; effect on obligation of secondary obligor	§ 39(c)	Release of underlying obligation
§ 2823	Delay in proceeding by creditor	§ 50	Effect on secondary obligation of obligee's lack of action to enforce underlying obligation
§ 2824	Indemnity from principal	§ 41(b)(i)	Modification of underlying obligation
§ 2825	Discharge of principal by operation of law—does not exonerate secondary obligor	§§ 19(b), 34, 50	Suretyship status—defenses of secondary obligor against obligee; When defenses of principal obligor may be raised by secondary obligor as defenses to secondary obligation; Effect on secondary obligation of obligee's lack of action to enforce underlying obligation
§ 2832	Ostensible principal may show suretyship	§§ 15(d), 32(2-3)	Interpretation of the secondary obligation—use of particular terms; Effect of suretyship status on duties of secondary obligor and obligee—undisclosed suretyship status and change in relationship of parties
§ 2837	Construction of contract—Rules of interpretation	§§ 5, 14, 49	Applicability of general legal principles; Interpretation of the secondary obligation—generally; Burden of persuasion with respect to impairment of recourse
§ 2838	Judgment against secondary obligor	§ 68	Preclusive effect on principal obligor of litigation between obligee and secondary obligor
§ 2839	Exoneration by performance or offer of	§§ 19(a, d), 46	Suretyship status—defenses of secondary obligor against obligee;

<b>California Civil Code Section</b>	<b>Topic or Title</b>	<b>Restatement of Suretyship</b>	<b>Topic or Title</b>
	performance		Tender of performance
§ 2845	Requiring creditor to pursue certain remedies; exoneration of secondary obligor by creditor's neglect to proceed	§§ 50-51	Effect on secondary obligation of obligee's lack of action to enforce underlying obligation; When obligee must first seek to collect by applying collateral for underlying obligation
§ 2846	Compelling principal to perform	§§ 18, 21	Suretyship status—recourse of secondary obligor against principal obligor; Principal obligor's duty of performance
§ 2847	Reimbursement of secondary obligor by principal	§§ 18, 22-23	Suretyship status—recourse of secondary obligor against principal obligor; Duty of principal obligor to reimburse secondary obligor; Measure of reimbursement to which secondary obligor is entitled
§ 2848	Enforcement of creditor's remedies against principal; contribution by cosureties	§§ 18(2)(d), 27-29, 31, 53(3), 55	When secondary obligor has a right of subrogation; Rights obtained through subrogation; Secondary obligor succeeds to priority status of obligee; Secondary obligor's right to return performance—obligee's right of set-off; Distinguishing cosuretyship from suretyship; Rights between secondary obligors—co-suretyship
§ 2849	Secondary obligor entitled to benefits of securities for performance	§§ 18(2)(d), 28(c), 42, 55(2)	When secondary obligor has a right of subrogation; Rights obtained through subrogation; Impairment of collateral; Rights between secondary obligors—co-suretyship
§ 2850	Property of principal first applied to discharge of obligation	§ 51	When obligee must first seek to collect by applying collateral for underlying obligation
§ 2854	Creditor entitled to benefits of securities for performance held by	§ 33	Secondary obligor's collateral available to obligee

<b>California Civil Code Section</b>	<b>Topic or Title</b>	<b>Restatement of Suretyship</b>	<b>Topic or Title</b>
	secondary obligor		
§ 2855	Arbitration award against principal; effect on secondary obligor	§ 67 comment d	Preclusive effect on secondary obligor of litigation between obligee and principal obligor
§ 2856	Waiver of suretyship rights and defenses; contract language	§§ 6, 48	Rules subject to agreement of parties; Waiver of suretyship defenses—consent

## Report

### Section 1 - Scope; Transactions Giving Rise to Suretyship Status

#### Paragraph (1)(a)

Accord: Section 2787 of the California Civil Code states that "[a] surety or guarantor is one who promises to answer for the debt, default, or miscarriage of another, or hypothecates property as security therefor." Cal. Civ. Code § 2787 (West Supp. 1999). See also Everts v. Matteson, 21 Cal. 2d 437, 447, 132 P.2d 476, 482 (1942) ("The suretyship relation . . . arises where two persons are under obligation to the same obligee, who is entitled to but one performance, as between the two who are bound, and one of them should ultimately bear the burden of the obligation.").

#### Paragraph (1)(b)

Accord: The obligee is "entitled to but one performance." Everts v. Matteson, 21 Cal. 2d 437, 447, 132 P.2d 476, 482 (1942); Westinghouse Credit Corp. v. Wolfer, 10 Cal. App. 3d 63, 67, 88 Cal. Rptr. 654, 656 (1970).

#### Paragraph (1)(c)

Accord: "The obligor ultimately responsible for the debt is the principal [obligor] and the other is the surety." Everts v. Matteson, 21 Cal. 2d 437, 447, 132 P.2d 476, 482 (1942).

#### Paragraph (2)

Accord: This subsection discusses the circumstances under which a secondary obligor might become liable under the secondary obligation. An example of subparagraph (2)(b)(i) would occur when the principal and the secondary obligor are jointly and severally liable to the obligee. See, e.g., United States Leasing Corp. v. DuPont, 69 Cal. 2d 275, 278, 444 P.2d 65,



67, 70 Cal. Rptr. 393, 395 (1968) (secondary obligors of lease "guarantee and promise, 'on demand . . . to pay . . . all rents and all other sums . . . in the amounts . . . and in the manner set forth in the Lease . . .").

See Revised U.C.C. § 9-102(71) (1999) (person is a secondary obligor if obligation is secondary or the obligor has a right of recourse against the debtor or another obligor).

An example of the application of subparagraph (2)(b)(ii) arises when the secondary obligor agrees to be obligated after default by the principal obligor. See, e.g., Davenport v. Stratton, 24 Cal. 2d 232, 236, 149 P.2d 4, 6 (1944) (secondary obligors of lease agreed "that if default shall at any time be made by [the principal obligor] in the payment of the rent . . . [the secondary obligors] will well and truly pay the said rent or any arrears thereof . . .").

#### Paragraph (3)(a)

Accord: See, e.g., Superior Wholesale Elec. Co. v. Cameron, 264 Cal. App. 2d 488, 493, 70 Cal. Rptr. 636, 639 (1968) ("No particular form of agreement is required to establish a suretyship contract. So long as the agreement establishes the intention to create such a contract, no set words and form are required."); Ingalls v. Bell, 43 Cal. App. 2d 356, 366, 110 P.2d 1068, 1074 (1941) ("As long as the agreement established the intention of creating a contract of guaranty, no set words and form were required."). See also Cal. Civ. Code §§ 2787, 2793 (West 1993 & Supp. 1999).

#### Paragraph (3)(b)

Accord: Section 2787 of the California Civil Code abolishes the distinction between sureties and guarantors and states that "[t]he terms and their derivatives, wherever used in this code or in any other statute or law of this state . . . , shall have the same meaning as defined in this section." Cal. Civ. Code § 2787 (West Supp. 1999). See also Superior Wholesale Elec. Co. v. Cameron, 264 Cal. App. 2d 488, 493, 70 Cal. Rptr. 636, 639 (1968) (rejecting the argument that a guaranty obligation could not have been intended because the letter in issue did not contain the word "guarantee"); Ingalls v. Bell, 43 Cal. App. 2d 356, 366, 110 P.2d 1068, 1074 (1941).

#### Paragraph (3)(c)

Accord: The California Civil Code contemplates that valid suretyship obligations can be either conditional or unconditional. For example, California Civil Code section 2806 states, "[a] suretyship obligation is to be deemed unconditional unless its terms import some condition precedent to the

liability of the surety." Cal. Civ. Code § 2806 (West 1993). California Civil Code section 2808 establishes rules of liability and notice for conditional suretyship obligations. Cal. Civ. Code § 2808 (West 1993).

Paragraph (3)(d)

Accord: Section 2788 of the California Civil Code states, "[a] person may become a surety even without the knowledge or consent of the principal." Cal. Civ. Code § 2788 (West 1993). See also Kelley v. Goldschmidt, 47 Cal. App. 38, 42, 190 P. 55, 57 (1920).

Paragraph (3)(e)

Accord: One application of this paragraph occurs when an obligee considers a secondary obligor to be a principal obligor and is ignorant of the suretyship relationship between the principal and secondary obligors. That application of this paragraph is supported by Leeke v. Hancock, 76 Cal. 127, 130, 17 P. 937, 938 (1888) ("One of the two joint makers of a note may be a surety only, as between himself and his co-promisor, and yet, as to the payee, his apparent and real character be that of principal."). See also Restatement of Suretyship § 32(2); Cal. Civ. Code § 2832 (West 1993).

Paragraph (3)(f)

Accord: California case law supports this paragraph. For example, deeds of trust are given to vendors of real property to secure payment of the purchase price. California courts have held that secondary obligors of such payment obligations are not entitled to the benefits of section 580b of the California Code of Civil Procedure, which bars an action for a deficiency judgment against the principal obligor after foreclosure of such a deed of trust. Cal. Code Civ. Proc. § 580b (West Supp. 1999); see also Heckes v. Sapp, 229 Cal. App. 2d 549, 40 Cal. Rptr. 485 (1964); Roberts v. Graves, 269 Cal. App. 2d 410, 75 Cal. Rptr. 130 (1969). The result is a situation similar to that described in this paragraph. The liability of the principal obligor is limited to the value of the property while the liability of the secondary obligor is not so limited, but the payment of the purchase price by the principal obligor will discharge the secondary obligor of its guaranty of the payment obligation.

**Section 2 - Contract Creating the Secondary Obligation**

In general: Under section 2787 of the California Civil Code, a "surety or guarantor is one who promises to answer for the debt, default, or miscarriage of another, or hypothecates property as security therefor." Cal. Civ. Code § 2787 (West Supp. 1999).

Paragraph (a)

Accord: Section 2788 of the California Civil Code states that "[a] person may become a surety even without the knowledge or consent of the principal." Cal. Civ. Code § 2788 (West 1993). This language encompasses a suretyship agreement between the obligee and the secondary obligor. Id.; see also Kelley v. Goldschmidt, 47 Cal. App. 38, 42, 190 P. 55, 57 (1920) (stating that "[a] guaranty is . . . an independent contract--that is, entirely independent of any contract of debt the payment of which is thus assured, and it follows that an action on a guaranty . . . is upon an independent contract of the guarantor with which the principal debtor has nothing to do").

Paragraph (b)

Accord: See, e.g., Superior Wholesale Elec. Co. v. Cameron, 264 Cal. App. 2d 488, 491-92, 70 Cal. Rptr. 636, 639 (1968) (treating letter to obligee, signed by principal and secondary obligors, as guaranty).

Paragraph (c)

Accord: Section 2787 of the California Civil Code includes in its definition of a secondary obligor one who "hypothecates property as security" for the "debt, default, or miscarriage of another." Cal. Civ. Code § 2787 (West Supp. 1999). See also Pearl v. General Motors Acceptance Corp., 13 Cal. App. 4th 1023, 1028, 16 Cal. Rptr. 2d 805, 807 (1993) (treating agreement under which plaintiff pledged stocks as security for debts as a guaranty) (citing Bridge v. Connecticut Mut. Life Ins. Co., 167 Cal. 774, 781-83, 141 P. 375 (1914)).

Paragraph (d)

Accord: See, e.g., T&R Painting Constr., Inc. v. St. Paul Fire & Marine Ins. Co., 23 Cal. App. 4th 738, 741-42, 29 Cal. Rptr. 2d 199, 200 (1994) (describing payment-bond agreement between secondary obligor and contractor under which secondary obligor agreed to pay subcontractors for labor and materials in the event that contractor failed to do so).

Paragraph (e)

Accord: See, e.g., Everts v. Matteson, 21 Cal. 2d 437, 447, 132 P.2d 476, 482 (1942) ("grantee of real property subject to a mortgage or trust deed who agrees to pay such indebtedness, becomes, as to the mortgagor or trustor, the principal debtor of the mortgagee or beneficiary, and the mortgagor or trustor occupies the relation of surety"); Westinghouse Credit Corp. v. Wolfer, 10 Cal. App. 3d 63, 67-68, 88 Cal. Rptr. 654, 567 (1970) ("When [third person] assumed appellant's debt . . . , he became the principal

obligor and [appellant] became the surety."); Parrish v. Greco, 118 Cal. App. 2d 556, 561, 258 P.2d 566, 569 (1953) ("if the debt be assumed by the grantee he becomes the principal debtor, while the mortgagor becomes the surety.") (quoting Brichetto v. Raney, 76 Cal. App. 232, 245 P. 235 (1926)).

#### Paragraph (f)

Accord: California courts view the situation described in the comment to paragraph (f)--where property subject to a mortgage is sold, but the purchaser does not assume the debt--as one in which the property becomes the principal obligor and the seller (the mortgagor) becomes the secondary obligor. See Braun v. Crew, 183 Cal. 728, 731, 192 P. 531, 533 (1920). Consequently, as the comment to paragraph (f) states, the purchaser, in effect, "becomes a principal obligor whose obligation is limited to the property." See also Parrish v. Greco, 118 Cal. App. 2d 556, 561, 258 P.2d 566, 569 (1953) ("where the purchaser or grantee of the mortgaged property takes it subject to the mortgage only, there being no expressed or implied agreement to assume the mortgage debt, he is bound only to the extent of the property . . .") (quoting Brichetto v. Raney, 76 Cal. App. 232, 245 P. 235, (1926)); Occidental Life Ins. Co. v. McCracken, 19 Cal. App. 2d 239, 240, 65 P.2d 130, 131 (1937) ("where a vendee takes land subject to a mortgage, the land becomes, so far as the mortgagor is concerned, as between him, the creditor, and the vendee, primarily liable for the payment of the debt, and the relation of principal and surety arises, the mortgagor being the surety and the land the principal debtor . . .").

### **Section 3 - When Principal Obligor and Secondary Obligor Are Parties to the Same Contract**

#### Paragraph (1)

Accord: See, e.g., Leeke v. Hancock, 76 Cal. 127, 130, 17 P. 937, 938 (1888) ("One of the two joint makers of a note may be a surety only, as between himself and his co-promisor, and yet, as to the payee, his apparent and real character be that of principal."). See also Cal. Com. Code § 3419 (West Supp. 1999).

#### Paragraph (2)

Accord: In the context of secondary obligor bonds required under California statutes, California Code of Civil Procedure section 996.410(a) states that a "beneficiary may enforce the liability on a bond against both the principal and sureties." Cal. Code Civ. Proc. § 996.410(a) (West Supp. 1999). According to section 996.460(a), that liability applies against the principal and secondary obligors jointly and severally. However, because

"if losses occur, the surety [on a surety bond] may recover from its principal," Lumbermens Mut. Cas. Co. v. Agency Rent-A-Car, Inc., 128 Cal. App. 3d 764, 769, 180 Cal. Rptr. 546, 550 (1982), the obligations of the principal are the underlying obligations. Thus, as viewed by the Restatement of Suretyship, the presence of the principal obligor on a surety bond does not add anything to the principal's underlying obligation.

For an example of the type of arrangement contemplated in paragraph (2), see the facts of Jensen v. Hugh Evans & Co., 18 Cal. 2d 290, 115 P.2d 471 (1941). In Jensen, the principal was a trustee who had agreed to administer the funds of the trust in a particular way. This was the "separate agreement" contemplated in paragraph (2). The surety bond agreement bound the trustee, as principal, and the Fidelity & Deposit Company of Maryland, as secondary obligor, to pay \$50,000 in the event that the trustee should fail to "honestly and faithfully" apply the funds derived from the sale of shares of beneficial interests in the trust in accordance with the provisions of the separate agreement. The underlying obligation, upon which the payment of the bond was conditioned, was the combination of the separate agreement and the trustee's undertaking to pay \$50,000 if he failed to "honestly and faithfully" discharge his duties under that agreement. 18 Cal. 2d at 292.

## **Section 4 - Relationship to Other Law**

### Paragraph (1)

Accord: Official Comment 7 to section 3-419 of the Uniform Commercial Code (adopted as California Commercial Code section 3419) states that the general law of suretyship applies to the rights of accommodation makers of negotiable instruments except to the extent displaced by the provisions of Article 3. This position is clarified in Commentary No. 11 of the Permanent Editorial Board for the Uniform Commercial Code, which discusses various questions regarding the rights of an accommodation maker under Article 3. See PEB Commentary No. 11, PEB Commentary on the Unif. Com. Code, 3B U.L.A. App. II (February 10, 1994). California courts, however, have not decisively stated whether suretyship law is always preempted by the law pertaining to negotiable instruments or secured transactions. In a decision based on the prior version of California Commercial Code Division 3, a California court refused to decide whether the law of negotiable instruments or of suretyship should apply when an accommodation maker's guaranty was a separate piece of paper from the underlying note, although the court did state in dictum that it had difficulty "accepting the premise that the rights of one who signs as a guarantor in the note itself are different from the rights of one who executes the guaranty on a different piece of paper." Flojo Int'l, Inc. v. Lassleben, 4 Cal. App. 4th 713, 722, 6 Cal. Rptr. 2d 99, 104 (1992) (declining to decide

whether "the rights of a guarantor are governed by a different code than the rights of an accommodation party" because in the case result was the same under either law).

#### Paragraph (2)

Accord: California Civil Code section 2787 states that "[a] 'letter of credit' [as defined in California Commercial Code § 5102(a)(10)] is not a form of suretyship obligation." Cal. Civ. Code § 2787 (West Supp. 1999). Under California Civil Code section 2787, this definition applies, regardless of whether the engagement is governed by Division 5 of the California Commercial Code.

### **Section 5 - Applicability of General Legal Principles**

Accord: Regarding the general law of contract formation, the court in R.H. Herron Co. v. Flack, 46 Cal. App. 374, 377, 189 P. 294, 295 (1920), stated that "[a] contract of guaranty is governed by the usual rules applicable to contracts in general with reference to an offer and acceptance thereof."

Other: California Commercial Code section 1103 states that general principles of law supplement the California Commercial Code unless displaced by the particular provisions of the California Commercial Code. Cal. Com. Code § 1103 (West 1964).

### **Section 6 - Rules Subject to Agreement of Parties**

Accord: Three sections of the California Civil Code support this section of the Restatement of Suretyship in the context of varying the statutorily provided protections for secondary obligors both by consent to actions by the obligee that would not otherwise be permissible or would result in a defense and by waiver of rights that the statutes provide. The first, section 3268, states that "[e]xcept where it is otherwise declared, the provisions of the foregoing titles of this part [including the provisions regarding suretyship agreements], in respect to the rights and obligations of parties to contracts, are subordinate to the intention of the parties . . . ; and the benefit thereof may be waived by any party entitled thereto, unless such waiver would be against public policy." Cal. Civ. Code § 3268 (West 1993). The second, section 3513, provides that "[a]ny one may waive the advantage of a law intended solely for his benefit. But a law established for a public reason cannot be contravened by a private agreement." Cal. Civ. Code § 3513 (West 1997). The third, section 2856(a), specifically in reference to suretyship relations, states that "[a]ny guarantor or other surety . . . may waive . . . [t]he guarantor or other surety's rights of subrogation, reimbursement, indemnification, and contribution and any other rights and defenses that are or may become available to the guarantor

or other surety by reason of Sections 2787 to 2855 [the suretyship provisions in the Civil Code], inclusive." Cal. Civ. Code § 2856(a) (West Supp. 1999).

Courts have frequently interpreted one or more of these provisions to permit parties to alter contractually the statutory requirements of the law of suretyship or to waive statutorily provided rights and defenses. See, e.g., Bloom v. Bender, 48 Cal. 2d 793, 804, 313 P.2d 568, 575 (1957) (permitting parties to agree by contract not to terminate liability of secondary obligor upon discharge of principal obligor, contrary to dictates of California Civil Code § 2809); River Bank America v. Diller, 38 Cal. App. 4th 1400, 1419, 45 Cal. Rptr. 2d 790, 800 (1995) (same); Pearl v. General Motors Acceptance Corp., 13 Cal. App. 4th 1023, 1030, 16 Cal. Rptr. 2d 805, 808 (1993) (permitting parties to waive protections of California Civil Code § 2815, which allows secondary obligor to revoke continuing guaranty); People v. Pac. Employers Ins. Co., 36 Cal. App. 3d 296, 300, 111 Cal. Rptr. 350, 352 (1973) (permitting parties to waive termination provisions for surety bonds found in California Civil Code § 2851); Brunswick Corp. v. Hays, 16 Cal. App. 3d 134, 138, 93 Cal. Rptr. 635, 638 (1971) (permitting parties to waive provisions of California Civil Code §§ 2845 and 2849); Wiener v. Van Winkle, 273 Cal. App. 2d 774, 786-87, 78 Cal. Rptr. 761, 769 (1969) (same); Engelman v. Bookasta, 264 Cal. App. 2d 915, 918, 71 Cal. Rptr. 120, 122 (1968) (same). In addition, in dictum, one court has made the blanket statement that "[t]he protections of the Civil Code pertaining to surety] contracts may be waived." See Canadian Community Bank v. Ascher Findley Co., 229 Cal. App. 3d 1139, 1154, 280 Cal. Rptr. 521, 530 (1991).

See annotations to section 48 for a more extensive discussion of the waiver of suretyship rights and defenses under California law.

## **Section 7 - Formation of the Contract Creating the Secondary Obligation--Generally**

Accord: In R.H. Herron Co. v. Flack, 46 Cal. App. 374, 377, 189 P. 294, 295 (1920), the court stated that "[a] contract of guaranty is governed by the usual rules applicable to contracts in general with reference to an offer and acceptance thereof."

## **Section 8 - When Notification of Acceptance of the Secondary Obligor's Offer Is Necessary for Creation of the Secondary Obligation**

### Paragraph (1)

Accord: Section 2795 of the California Civil Code states that "[u]nless notice of acceptance is expressly required, an offer to become a surety may be

accepted by acting upon it, or by acceptance upon other consideration." Cal. Civ. Code § 2795 (West 1993).

Section 2795 also permits an absolute suretyship obligation to become binding without notice of acceptance to the secondary obligor. An absolute obligation promises unconditionally to be responsible for the principal obligation in the event of the default of the principal obligor. See, e.g., Davenport v. Stratton, 24 Cal. 2d 232, 236, 243, 149 P.2d 4, 6, 9 (1944) (stating that "guaranty was absolute in form" when guaranty agreement promised that secondary obligors "will well and truly pay the said rent or any arrears thereof" in the event of default by the principal obligor); Thorpe v. Story, 10 Cal. 2d 104, 107-08, 118, 73 P.2d 1194, 1202 (1937) (noting that guaranty--which stated that secondary obligors "do hereby unconditionally guaranty"--was "an absolute or unconditional guaranty," which "is binding upon the guarantor without notice of acceptance").

#### Paragraph (2)

Contra: Section 2795 of the California Civil Code draws no distinction between cases in which the secondary obligor has adequate means of learning of the obligee's acceptance and those in which the secondary obligor does not. Cal. Civ. Code § 2795 (West 1993).

### **Section 9 - Consideration**

#### Paragraph (1)

Accord: Section 2792 of the California Civil Code states that "a consideration distinct from that of the original obligation" must exist in all cases, except those in which the "suretyship obligation is entered into at the same time with the original obligation, or with the acceptance of the latter by the creditor, and forms with that obligation a part of the consideration to him." Cal. Civ. Code § 2792 (West 1993). These exceptions to the consideration requirement appear to fall generally within the exception in section 9, paragraph (2)(a) of the Restatement of Suretyship. However, as noted below, the exceptions in paragraphs (2)(b) and (c), and, possibly, (d), do not appear to be recognized under California law. For an example of a suretyship arrangement held invalid for lack of consideration, see Rusk v. Johnston, 18 Cal. App. 2d 408, 409, 63 P.2d 1167 (1937) (declining to find consideration for guaranty in light of "substantial evidence that the guaranty was not requested nor given until after the [underlying obligation] was executed and the consideration for [the underlying obligation] passed").

#### Paragraph (2)(a)



Accord: Section 2792 of the California Civil Code permits a suretyship obligation to exist in the absence of additional consideration "with the acceptance of the [original obligation] by the creditor," provided that the suretyship obligation "forms with that [original] obligation a part of the consideration" to the creditor (obligee). Cal. Civ. Code § 2792 (West 1993). This is true under section 2792 even if the suretyship agreement is not entered into at the same time as the original obligation.

California case law is also generally in accord with paragraph (2)(a). In Stroud v. Thomas, 139 Cal. 274, 275, 72 P. 1008 (1903), the court held that a suretyship obligation was binding even though it was executed by the secondary obligor without additional consideration after the underlying note had been executed by the principal obligors. Because the suretyship obligation had been part of the bargained-for exchange between the obligee and the principal obligors, the subsequent execution by the secondary obligor, "being in pursuance of the original agreement, relate[d] back to and [took] effect the same as if it had been coincident with the execution by the principal debtors." Id. Cf. Rusk v. Johnston, 18 Cal. App. 408, 409, 63 P.2d 1167 (1937) (declining to find consideration for guaranty in light of "substantial evidence that the guaranty was not requested nor given until after the [underlying obligation] was executed and the consideration for [the underlying obligation] passed").

In addition, one California court appears to have gone slightly beyond the position in paragraph 2(a), finding consideration for a guaranty for a bundle of loans, even though the first loan was made before the guaranty was considered. In Beverly Hills Nat'l Bank v. Glynn, 267 Cal. App. 2d 859, 73 Cal. Rptr. 808 (1968), on February 14, 1963, a secondary obligor executed one guaranty that eventually was alleged to guaranty three loans. The first loan was made on February 1, the second on February 13, and the third on April 22. Even though the note for the February 1st loan "had been executed and accepted prior to the time the guaranty was considered," the court found merit in the contention "that the successive events were part of a single transaction and that, for this reason, the guaranty is supported by consideration." Id. at 868, 73 Cal. Rptr. at 813. The court stated that "the granting of the February 13th and April 22nd loans on the faith of that guaranty was all the consideration required to make effective the included guaranty of the February 1st note." Id. at 868, 73 Cal. Rptr. at 814. See also Steffen & Johns, The After-Acquired Surety: Commercial Paper, 59 Calif. L. Rev. 1459 (1971).

#### Paragraph (2)(b)

Contra: Section 2792 of the California Civil Code states that a suretyship obligation must be supported by consideration distinct from that of the

original obligation "in all other cases," except those covered under paragraph (2)(a), *supra*, and those in which the suretyship and principal obligations are executed concurrently. Cal. Civ. Code § 2792 (West 1993). Neither the California Civil Code nor the case law recognizes an exception for written suretyship agreements that recite nominal consideration. Although section 1614 of the California Civil Code establishes that a written contract is presumptive evidence of consideration, Cal. Civ. Code § 1614 (West 1982), this presumption is rebuttable. See, e.g., Kott v. Hilton, 45 Cal. App. 2d 548, 552-54, 114 P.2d 666, 668 (1941) (upholding trial court's finding that written agreement was not supported by consideration). Furthermore, courts have interpreted the presumption raised by section 1614 as placing only a burden of producing evidence--as opposed to a burden of proof--on the party seeking to claim want of consideration. See, e.g., Rancho Santa Fe Pharmacy, Inc. v. Seyfert, 219 Cal. App. 3d 875, 884, 268 Cal. Rptr. 505, 510 (1990).

The consideration need not run to the secondary obligor, however; a significant new benefit to the primary obligor will suffice. Kenny v. Jos. Herspring & Co., 53 Cal. App. 628, 200 P. 757 (1921); Irving v. Irwin, 133 Cal. App. 374, 24 P.2d 215 (1933); California Bank v. Kenoyer, 2 Cal. App. 2d 367, 37 P.2d 836 (1934).

#### Paragraph (2)(c)

Other: The Comment to paragraph (2)(c) indicates that this paragraph refers to statutes under which a seal or a statutory substitute for a seal creates a binding suretyship obligation, regardless of the existence or non-existence of separate consideration. Section 1629 of the California Civil Code abolishes the distinction between sealed and unsealed contracts. See Cal. Civ. Code § 1629 (West 1985). Therefore, paragraph (2)(c) is irrelevant in California.

Accord: Part 2, Title 14, chapter 2 of the California Code of Civil Procedure does appear to establish a statutory scheme for creating a certain class of suretyship obligation regardless of the presence or absence of consideration. This portion of the Code applies to bonds and undertakings, including surety bonds, executed pursuant to state statutes. Section 995.320 of the California Code of Civil Procedure establishes the requirements for the contents of the bond and the liability of the secondary obligors. See Cal. Code Civ. Proc. § 995.320 (West Supp. 1999). No requirement of consideration appears in this section, and section 995.320(b) states that "[t]he sureties signing the bond are jointly and severally liable on the obligations of the bond." Id. § 995.320(b).

#### Paragraph (2)(d)

Other: Although California courts have long recognized the principle that a promisee's reasonable reliance on a promise may sometimes bind the promisor, even if the promise is unsupported by consideration, see, e.g., Drennan v. Star Paving Co., 51 Cal. 2d 409, 413, 333 P.2d 757, 759 (1958), they have never explicitly employed this approach in a suretyship or guaranty case. The plain language of section 2792 of the California Civil Code requires consideration "in all other cases," except those in which "[the] suretyship obligation is entered into at the same time with the original obligation, or with the acceptance of the latter by the creditor, and forms with that obligation a part of the consideration to him . . . ." Cal. Civ. Code § 2792 (West 1993). The ability to rely on the guaranty, however, may be the exact consideration for which the obligee bargained. In California Bank v. Kenoyer, 2 Cal. App. 2d 367, 369, 37 P.2d 836, \_\_\_, (1934), the creditor agreed to forebear in enforcing a judgment in return for a guaranty; the court found the detriment suffered by the creditor on delaying proceedings for the enforcement of the judgment to constitute consideration for the guaranty. The Comment to Restatement of Suretyship section 9 recognizes this, stating that reliance by an obligee "often can be found to have been bargained for." See annotation to paragraph 2(b).

## **Section 10 - Capacity**

### Paragraph (1)

Accord: The secondary obligation is contractual and is governed by section 1556 of the California Civil Code, which provides that "[a]ll persons are capable of contracting, except minors, persons of unsound mind, and persons deprived of civil rights." Cal. Civ. Code § 1556 (West 1982).

### Paragraph (2)

Accord: Legal persons, such as corporations, are in general given the same rights as natural persons, including the right to enter into contracts. See, e.g., Cal. Corp. Code § 207 (West 1999). The secondary obligation is contractual and is governed by section 1556 of the California Civil Code, which provides that "[a]ll persons are capable of contracting, except minors, persons of unsound mind, and persons deprived of civil rights." Cal. Civ. Code § 1556 (West 1982).

### Paragraph (3)

No relevant California authority.

## **Section 11 - Statute of Frauds**

Paragraph (1)

Accord: Section 2793 of the California Civil Code provides that a contract creating a secondary obligation must be in writing and signed by the secondary obligor unless an exception applies. Cal. Civ. Code § 2793 (West 1993).

Section 1624(b) of the California Civil Code provides that a contract to answer for the debt of another must be in writing and "subscribed by the party to be charged or by the party's agent." Cal. Civ. Code § 1624(b) (West Supp. 1999)

Paragraph (2)(a)

No relevant California authority.

Paragraph (2)(b)

No relevant California authority.

Paragraph (2)(c)

Other: Whether the promise to pay for the debt of another is original or collateral depends largely on the determination of whether the direct object of the promise is to become liable on the default of the principal obligor or, in the alternative, the object of the promise is to subserve some purpose of the secondary obligor, although the effect is to pay the debtor's obligation. See Ackley v. Prime, 99 Cal. App. 534, 539-40, 278 P. 932, 934 (1929).

Paragraph (3)(a)

Other: Under California law, where the promise creating a secondary obligation is upon consideration beneficial to the secondary obligor, it need not be in writing, whether the consideration moves from either party to the original obligation or from another. Cal. Civ. Code § 2794(4) (West 1993).

Paragraph (3)(b)(i)

Accord: Section 2794(1) of the California Civil Code provides that a promise to answer for the obligation of another is an original obligation and not a secondary obligation within the Statute of Frauds where the promise is made by one who has received property of another upon an undertaking to apply it pursuant to such promise. Cal. Civ. Code § 2794(1) (West 1993).

Paragraph (3)(b)(ii) and (b)(iii)

No relevant California authority.

Paragraph (3)(c)

Accord: Section 2794(4) of the California Civil Code provides that a contract to answer for the debt of another is not within the Statute of Frauds where the promise is upon consideration beneficial to the promisor. Cal. Civ. Code § 2794(4) (West 1993); see Farr & Stone Ins. Brokers, Inc. v. Lopez, 61 Cal. App. 3d 618, 621, 132 Cal. Rptr. 641, 642 (1976). See also Cal. Civ. Code § 2794(1) (West 1993) (a contract to answer for the debt of another is not within the Statute of Frauds where the promisor receives a discharge from an obligation, in whole or in part, in consideration of such promise).

Paragraph (3)(d)

Contra: A promise by a payor under a promissory note to secondary obligors to partially indemnify them as secondary obligors is within the Statute of Frauds. See McClendon v. Heisinger, 42 Cal. App. 780, 184 P. 52 (1919).

Paragraph (3)(e)

Other: Section 2794(2) of the California Civil Code provides that the contract of the secondary obligor is not within the Statute of Frauds where the secondary obligor receives consideration under circumstances that render it the principal obligor. Cal. Civ. Code § 2794(2) (West 1993).

Paragraph (3)(f)

Accord: Section 2794(6) of the California Civil Code provides that a holder of an instrument for the payment of money who transfers it and enters into a promise respecting such instrument is deemed to have made an original obligation that is not within the Statute of Frauds. Cal. Civ. Code § 2794(6) (West 1993).

Paragraph (3)(g)

Accord: Section 2794(5) of the California Civil Code provides that a factor selling merchandise for a commission and acting as a secondary obligor in connection with the sale is deemed to have made an original obligation that is not within the Statute of Frauds. Cal. Civ. Code § 2794(5) (West 1993).

Paragraph (3)(h)

Accord: Under California law, "there is not a contract to answer for the debt of another within the statute of frauds where the alleged guarantor promises the debtor, rather than the creditor to pay the . . . debt." King v. Smith, 33 Cal. 2d 71, 74, 199 P.2d 308, 310 (1948).

## Section 12 - When Secondary Obligation Is Voidable Due to Misrepresentation

### Paragraph (1)

Accord: Under California law, "the [obligee] owes to the surety a duty of continuous good faith and fair dealing." Sumitomo Bank of Cal. v. Iwasaki, 70 Cal. 2d 81, 85, 447 P.2d 956, 73 Cal. Rptr. 564 (1968). An obligee's fraud, "which may consist of intentional or negligent misrepresentation or active suppression of the truth," will void the secondary obligation as to any subsequently incurred liability. Id.

### Paragraph (2)

Accord: Under California law, fraud of the principal obligor will not relieve a secondary obligor who acted at the request of the principal obligor, if the obligee did not have notice of the fraud and did not participate in it. See Pierce v. Wright, 117 Cal. App. 2d 718, 724, 256 P.2d 1049, 1052 (1953).

### Paragraph (3)

Accord: Under California law, an obligee has a duty to disclose to the secondary obligor facts that the obligee has reason to believe materially increase the secondary obligor's risk beyond that which the obligee has reason to believe the secondary obligor intends to assume, which facts the obligee believes are unknown to the secondary obligor, and which the obligee has reasonable opportunity to communicate to the secondary obligor. Where the secondary obligor assents to the secondary obligation at the request of the principal obligor rather than the obligee, the obligee may assume that the secondary obligor will acquire from the principal obligor all such information. Sumitomo Bank of Cal. v. Iwasaki, 70 Cal. 2d 81, 88-93, 447 P.2d 956, 73 Cal. Rptr. 564 (1968).

### Paragraph (4)

Accord: See Sumitomo Bank of Cal. v. Iwasaki, 70 Cal. 2d 81, 88-93, 447 P.2d, 956, 73 Cal. Rptr. (1968), discussed in paragraph (3) above.

### Paragraph (5)

No relevant California authority.

### Paragraph (6)

Accord: See Sumitomo Bank of Cal. v. Iwasaki, 70 Cal. 2d 81, 88-93, 447 P.2d, 956, 73 Cal. Rptr. (1968), discussed in paragraph (3) above.

## Section 13 - Assignment of Obligee's Rights

### Paragraph (1) (a)

No relevant California authority.

### Paragraph (1)(b)

Accord: Under California law, an assignment is ineffective if forbidden by statute or otherwise by public policy. Pacific Electric Railway Co. v. Commonwealth Bonding & Casualty Ins. Co., 55 Cal. App. 704, 707-8, 204 P. 262 (1921).

### Paragraph (1)(c)

Accord: A contractual prohibition against assignment is effective as long as it does not violate statutory provisions. Francis v. Rogers & Wells, 210 Cal. App. 3d 336, 342, 258 Cal. Rptr. 454 (1989); Goodley v. Wank & Wank, Inc., 62 Cal. App. 3d 389, 395, 133 Cal. Rptr. 83 (1976); Kracht v. Perrin, Gartland & Doyle, 219 Cal. App. 3d 1019, 1023-24 268 Cal. Rptr. 637 (1990); Masterson v. Sine, 68 Cal. 2d 222, 230, 436 P.2d 561, 566, 65 Cal. Rptr. 545, 550 (1968); Thomas v. Thomas, 192 Cal. App. 2d 771, 779, 13 Cal. Rptr. 872 (1961).

### Paragraph (2 & 3)

No relevant California authority.

### Paragraph (4)(a)

Accord: California Commercial Code section 9318(4) provides that "[a] term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in chattel paper or a security interest in a general intangible for money due or to become due . . . ." Cal. Com. Code § 9318(4) (West 1990).

The Revised Division 9 of the California Commercial Code ("Revised Division 9"), which will take effect July 1, 2001, embodies provisions similar to those of paragraph 4(a). See Revised Division 9 § 9406(d)(1) and (2) (1999) (term in promissory note or legal restriction which prohibits, restricts or requires consent for its assignment or provides that assignment of the security interest will give rise to a default or breach is ineffective); see Revised Division 9 § 9407(a) (1999) (terms in lease agreement that prohibit, restrict, or require consent for the assignment of a security interest in an interest under the lease contract or which provide

that assignment of an interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the lease are generally ineffective); see Revised Division 9 § 9203(f) and (g) (1999) (the attachment of a security interest in collateral ... is also attachment of a security interest in a supporting obligation for the collateral; when an obligee transfers an obligation that is secured by a security interest, the security interest transfers along with the obligation); see Revised Division 9 § 9308(d) and (e) (1999) (When obligee perfects a security interest in collateral, subsection (d) provides for the perfection of a security interest in the supporting obligation for the collateral. When obligee perfects a security interest in a right to payment or performance, subsection (e) provides for perfection of a security interest in a security interest, mortgage, or other lien on personal or real property which secures the right.).

#### Paragraph (4)(b)

Accord: Under California law, a cause of action for breach of contract is generally assignable absent some special rule forbidding it. See Cal. Civ. Code § 954 (West Supp. 1999), Goodley v. Wank & Wank, Inc., 62 Cal. App. 3d 389, 133 Cal. Rptr. 83 (1976). Contractual language barring the assignment of the contract does not prevent assignment of a cause of action arising from breach. See Shively v. Semi-Tropic Land & Water Co., 99 Cal. 259, 261, 33 P. 848 (1893).

#### Paragraph (5)

Accord: Section 1084 of the California Civil Code provides that the transfer of a thing transfers the incidents. Cal. Civ. Code § 1084 (West 1982). Under California law, whatever operates as an assignment of the debt will operate as an assignment of the secondary obligation. See Thorpe v. Storey, 10 Cal. 2d 104, 124, 73 P.2d 1194, 1205 (1937); Champion Home Builders Co. v. Sipes, 219 Cal. App. 3d 1415, 1423, 269 Cal. Rptr. 75, 79 (1990).

### **Section 14 - Interpretation of the Secondary Obligation - Generally**

Accord: Section 2837 of the California Civil Code provides that in interpreting the terms of a contract of suretyship, the same rules are to be observed as in the case of other contracts. Cal. Civ. Code § 2837 (West 1993); see also, e.g., United States Leasing Corp. v. DuPont, 69 Cal. 2d 275, 284, 444 P.2d 65, 71, 70 Cal. Rptr. 393, 399 (1968); Bloom v. Bender, 48 Cal. 2d 793, 893, 313 P.2d 568, 574 (1957); White v. Indemnity Ins. Co., 246 Cal. App. 2d 160, 162, 54 Cal. Rptr. 630, 632 (1966); Standard Oil Co. v. Houser, 101 Cal. App. 2d 480, 487, 225 P.2d 539, 543 (1950).

### **Section 15 - Use of Particular Terms**



#### Paragraph (a)

Other: Section 2787 of the California Civil Code provides that the distinction between sureties and guarantors is abolished. Cal. Civ. Code § 2787 (West Supp. 1999). A surety or guarantor is one who promises to answer for the debt, default, or miscarriage of another, or hypothecates property as security therefor. See also annotation to section 15(c).

#### Paragraph (b)

Accord: Section 2800 of the California Civil Code provides that "[a] guaranty to the effect that an obligation is good, or is collectible, imports that the [principal obligor] is solvent, and that the demand is collectible by the usual legal proceedings, if taken with reasonable diligence." Cal. Civ. Code § 2800 (West 1993). Section 2801 of the California Civil Code provides that "a guaranty . . . is not discharged by an omission to take proceedings upon the principal debt, or upon any collateral security for its payment, if no part of the debt could have been collected thereby." Cal. Civ. Code § 2801 (West 1993). Section 2802 of the California Civil Code provides that "the removal of the [principal obligor] from the state, leaving no property therein from which the obligation might be satisfied, is equivalent to the insolvency of the [principal obligor] in its effect upon the rights and obligations of the surety." Cal. Civ. Code § 2802 (West 1993). The complaint in an action involving a guaranty of collection must allege that (1) the claims are not good or collectible, (2) the claims have been reduced to judgment and execution thereon returned unsatisfied, (3) the principal obligors are insolvent, or (4) for some reason legal proceedings would be unavailing. Menefee v. Robert A. Klein & Co., 121 Cal. App. 294, 296-97, 9 P.2d 219, 219-20 (1932).

#### Paragraph (c)

Accord: As between co-obligors on the same contract or instrument, the word "surety" written opposite the name of one of the obligors or the signature is accompanied by words indicating that the co-obligor is acting as a secondary obligor. Aud v. Magruder, 10 Cal. 282, 291 (1858); Cal. Com. Code § 3419(c) (West Supp. 1999).

#### Paragraph (d)

Contra: In Wexler v. McLucas, 48 Cal. App. 3d Supp. 9, 12-14, 121 Cal. Rptr. 453, 455-56 (1975), the court declined to acknowledge any secondary meaning or legal significance to the term "co-signer."

Other: Section 2832 of the California Civil Code provides that "one who appears to be a principal, whether by the terms of a written instrument or

otherwise, may show that he is in fact a surety, except as against persons who have acted on faith of his apparent character of principal." Cal. Civ. Code § 2832 (West 1993). In an action brought against a husband and wife as principals, evidence sustained a finding that the wife signed as comaker, notwithstanding evidence offered by the wife as permitted by this section, tending to show that she was a secondary obligor. First Nat'l Bank v. Williams, 54 Cal. App. 537, 538-39, 202 P. 164, 164-65 (1921). See also Cal. Com. Code § 3419 (Supp. 1999) and related commentary.

#### Paragraph (e)

See annotations to section 16.

### **Section 16 - Continuing Guaranty**

Accord: Section 2814 of the California Civil Code provides that "[a] guaranty relating to a future liability of the principal [obligor], under successive transactions, which either continues his liability or from time to time renews it after it has been satisfied, is called a continuing guaranty." Cal. Civ. Code § 2814 (West 1993). Section 2815 of the California Civil Code provides that "[a] continuing guaranty may be revoked at any time by the surety, in respect to future transactions, unless there is a continuing consideration as to such transactions which the surety does not renounce." Cal. Civ. Code § 2815 (West 1993). The death of an individual secondary obligor, with the creditor's knowledge thereof, will revoke a continuing guaranty with respect to future advances, unless the parties have otherwise agreed by explicit language. American City Bank v. Tourtelot, 86 Cal. App. 3d 585, 590, 150 Cal. Rptr. 361, 364 (1978).

### **Section 17 - Effect of Suretyship Status on Rights and Duties of the Secondary Obligor and Generally**

#### Paragraph (1)

Accord: In California, the rights of the secondary obligor against the principal obligor are (i) those existing as a result of any contract between them and (ii) the rights that arise out of suretyship, which are set forth in the California Civil Code. See also annotations to section 18.

#### Paragraph (2)

Accord: A secondary obligor cannot be held beyond the terms or legal effect of the secondary obligor's engagement. See Callum v. Hartford Accident & Indemnity Co., 186 Cal. App. 2d Supp. 885, 337 P.2d 259 (1959). See also annotations to sections 19 and 32 through 49 below.

## **Section 18 - Suretyship Status and Recourse of Secondary Obligor Against Principal Obligor**

### Paragraph (1)

Accord: Section 2846 of the California Civil Code provides that a secondary obligor may compel the principal obligor to perform the obligation when due. Cal. Civ. Code § 2846 (West 1993). Additionally, section 2847 of the California Civil Code provides that if the secondary obligor satisfies the principal obligation in whole or in part, with or without legal proceedings, the principal is bound to reimburse what he has disbursed, including necessary costs and expenses. Cal. Civ. Code § 2847 (West 1993).

### Paragraph (2)(a)

Accord: Section 2846 of the California Civil Code provides that a secondary obligor may compel the principal obligor to perform the obligation when due. Cal. Civ. Code § 2847 (West 1993). After the obligation becomes payable, the secondary obligor may, before paying the obligation and irrespective of whether the secondary obligor has been sued, maintain an action against the obligor to compel the obligor to pay the debt or perform the obligation. See Josephian v. Lion, 66 Cal. App. 650, 227 P. 204 (1924). For further discussion, see annotation to section 21.

### Paragraph 2(b)

Accord: Section 2847 of the California Civil Code provides that where the secondary obligor satisfies the principal obligation in whole or in part, with or without legal proceedings, the secondary obligor is entitled to reimbursement from the principal obligor. Cal. Civ. Code § 2847 (West 1993). For further discussion, see annotations to sections 22 through 24.

### Paragraph (2)(c)

See annotation to Section 26.

### Paragraph (2)(d)

Accord: Section 2848 of the California Civil Code provides that a secondary obligor, upon satisfying the obligation of the principal obligor, is entitled to enforce every remedy that the creditor then has against the principal obligor to the extent of reimbursing what the secondary obligor has expended. Cal. Civ. Code § 2848 (West 1993). Further, section 2849 of the California Civil Code provides that a secondary obligor is entitled to the benefit of every security for the performance of the principal

obligation held by the creditor. Cal. Civ. Code § 2849 (West 1993). Unlike reimbursement, the right of subrogation is available to a secondary obligor only upon total satisfaction of the underlying debt by such secondary obligor. There is, for significant policy reasons, no such thing as partial subrogation. See annotations to sections 27 through 29.

## **Section 19 - Suretyship Status - Defenses of Secondary Obligor Against Obligee**

### Paragraph (a)

Accord: Section 2839 of the California Civil Code provides that performance of the principal obligation exonerates a secondary obligor. Cal. Civ. Code § 2839 (West 1993).

### Paragraph (b)

Accord: Section 2810 of the California Civil Code provides that a secondary obligor is liable notwithstanding mere personal disability of the principal obligor, though the disability be such as to make the contract void against the principal obligor; but the secondary obligor is not liable if for any other reason there is not liability upon the part of the principal obligor at the time of the execution of the contract, or the liability of the principal obligor thereafter ceases, unless the secondary obligor has assumed liability with knowledge of the existence of the defense. Cal. Civ. Code § 2810 (West 1993). Section 2825 of the California Civil Code provides that a secondary obligor is not exonerated by the discharge of the principal obligor by operation of law, without the intervention or omission of the obligee. Cal. Civ. Code § 2825 (West 1993). For further discussion, see annotation to section 34.

### Paragraph (c)

See annotations to sections 37-45.

### Paragraph (d)

Accord: Section 2839 of the California Civil Code provides that an offer of performance duly made as provided therein exonerates a secondary obligor. Cal. Civ. Code § 2839 (West 1993).

## **Section 20 - When Principal Obligor Is Charged With Notice of Secondary Obligation**

Other: California Civil Code section 2788 and the Restatement of Suretyship take a similar approach, and only differ in that the Restatement's requirements to impute knowledge to the principal obligor are more specific. Section 2788 of the California Civil Code provides that a person may become a

secondary obligor without the knowledge or consent of the principal obligor. Cal. Civ. Code § 2788 (West 1993). Under California law, the duties of the principal obligor and the corresponding rights of the secondary obligor are the same regardless of whether the principal obligor has notice of the secondary obligation. For example, section 2846 of the California Civil Code states that a secondary obligor may compel the principal obligor to perform the obligation when due, but does not differentiate between situations in which the principal obligor is charged with notice of the secondary obligation and those in which the principal obligor is not. Cal. Civ. Code § 2846 (West 1993).

## **Section 21 - Principal Obligor's Duty of Performance; Exoneration**

### Paragraphs (1) and (2)

Accord: Section 2846 of the California Civil Code states that a secondary obligor may compel the principal obligor to perform the obligation when due. Cal. Civ. Code § 2846 (West 1993). An action may be brought by the secondary obligor to compel the principal obligor to satisfy the underlying obligation even though the secondary obligor has not performed its obligation. See Escrow Agents' Fidelity Corp. v. Superior Court, 4 Cal. App. 4th 491, 5 Cal. Rptr. 2d 698 (1992); Karn v. Wills, 50 Cal. App. 2d 604 (1942); Cal. Code of Civ. Proc. § 1050 (West 1980) (providing that an action by a secondary obligor for the purpose of compelling principal obligor to satisfy a debt due to another). Furthermore, the theory of quia timet (action for relief against anticipated injury) allows a secondary obligor to prevent dissipation of funds that could be used to satisfy the principal obligation. See Escrow Agents' Fidelity Corp. v Superior Court, 4 Cal. App. 4th 491, 5 Cal. Rptr. 2d 698.

### Paragraph (3)

Other: Section 2846 of the California Civil Code does not differentiate between situations in which the principal obligor is charged with notice of the secondary obligation and those in which the principal obligor has no knowledge thereof. Cal. Civ. Code § 2846 (West 1993).

Note: Escrow Agents' Fidelity is a perfect illustration of the observation expressed in the Reporter's Note to section 21(j) of the Restatement of Suretyship that courts often confuse the "equity of exoneration" (i.e., a secondary obligor's right to compel the principal to perform the underlying obligation) and quia timet (action for relief against anticipated injury). Although couched in terms of "quia timet," Escrow Agents' Fidelity expresses "equity of exoneration" language while relying upon a Tenth Circuit case cited in the Restatement of Suretyship as a classic example of the judicial confusion of the two doctrines. Escrow Agents' Fidelity Corp.

v. Superior Court, 4 Cal. App. 4th 491, 495, 5 Cal. Rptr. 2d 698, 701 (1992).

## **Section 22 - Duty of Principal Obligor to Reimburse Secondary Obligor**

Accord: Section 2847 of the California Civil Code gives the secondary obligor a right to reimbursement by the principal obligor whether or not the principal obligor is charged with notice of the secondary obligation. See Golden Eagle Ins. Co. v. First Nationwide Financial Corp., 26 Cal. App. 4th 160, 31 Cal. Rptr. 2d 815 (1994). See also the annotation to section 26.

See annotation to section 20.

## **Section 23 - Measure of the Reimbursement to Which the Secondary Obligor Is Entitled**

### Paragraph (1)

Accord: Civil Code Section 2847 permits the secondary obligor to recover reimbursement for necessary costs and expenses. See Louisville Title Ins. Co. v. Surety Title & Guaranty Co., 60 Cal. App. 3d 781, 132 Cal. Rptr. 63 (1976).

## **Section 24 - When the Duty to Reimburse Does Not Arise**

### Paragraph (1) (c)

Accord: In Heckes v. Sapp, 229 Cal. App. 2d 549, 554-55, 40 Cal. Rptr. 485, 489 (1964), the court (in dictum) stated that a secondary obligor would not have a right of reimbursement against a principal protected by California Code of Civil Procedure section 580b, which prohibits deficiency judgments against certain purchase money obligors. The secondary obligors had argued that they were protected by section 580b because their statutory right of reimbursement against the principal obligor would indirectly expose the obligor to deficiency liability. The court reasoned that there would be no such right of reimbursement precisely because that would indirectly avoid the anti-deficiency legislation.

## **Section 25 - Collateral for Principal Obligor's Duty to Reimburse Also Secures Principal Obligor's Duty to Perform**

Other: Section 2854 of the California Civil Code provides that "a creditor is entitled to the benefit of everything which a surety has received from the debtor by way of security for the performance of the obligation, and may, upon the maturity of the obligation, compel the application of such security to its satisfaction." Cal. Civ. Code § 2854 (West 1999).

## Section 26 - Restitution

See annotation to section 22.

## Section 27 - When Secondary Obligor Has a Right of Subrogation

In general: Section 2848 of the California Civil Code provides that a secondary obligor, upon satisfying the obligation of the principal, is entitled to enforce every remedy that the creditor then has against the principal to the extent of reimbursing what the secondary obligor has expended. Cal. Civ. Code § 2848 (West 1993). There are, however, two conflicting lines of case authority in California with respect to a secondary obligor's subrogation to the rights of the creditor against the principal obligor. One example of a case that expounds the position contrary to the Restatement of Suretyship is Regents of Univ. of Cal. v. Hartford Accident & Indem. Co., 21 Cal. 3d 624, 581 P.2d 197, 147 Cal. Rptr. 486 (1978), where the Supreme Court of California followed the older view that a secondary obligor who pays the principal debt extinguishes that obligation and thus cannot sue the debtor as the subrogee of the original debt. More recent cases have held that a secondary obligor who has paid the principal obligation is subrogated to all of the creditor's collection rights against the debtor. See, e.g., Flojo Int'l, Inc. v. Lassleben, 4 Cal. App. 4th 713, 6 Cal. Rptr. 2d 99 (1992). In Flojo Int'l, a secondary obligor who satisfied a guaranteed note brought suit against the maker for amounts paid on the note by the secondary obligor to the obligee, default interest, costs, and attorney fees incurred in its collection, all in accordance with the terms of the note. The court cited section 3415(5) of the California Commercial Code, which provided that "an accommodation party is not liable to the party accommodated, and if he pays the instrument has a right of recourse on the instrument against such party." Cal. Com. Code § 3415(5) (West 1964) (subsequently repealed, see Cal. Com. Code § 3419 (West Supp. 1999)). Therefore, plaintiff was entitled to enforce the note against the principal in accordance with its terms, including an increased default interest rate and an award of attorneys fees. When a secondary obligor satisfies the obligations of the principal, the secondary obligor is subrogated to the rights of the creditor and "is entitled to enforce every remedy which the creditor then has against the principal." Flojo Int'l, 4 Cal. App. 4th at 722, 6 Cal. Rptr. 2d at 104 (citing Cal. Civ. Code § 2848).

## Section 28 - Rights Obtained Through Subrogation

### Paragraphs (1)(a) and (1)(c)

Accord: See Cal. Civ. Code § 2848 (West 1993); see also Golden Eagle Ins. Co. v. First Nationwide Fin. Corp., 26 Cal. App. 4th 160, 31 Cal. Rptr. 2d 815 (1994), which held that a secondary obligor who satisfied a contractor's

obligations to a subcontractor in full was entitled to enforce mechanics' liens rights previously held by the obligee subcontractor.

Paragraph (1)(b)

Accord: Section 2848 of the California Civil Code provides, inter alia, that a secondary obligor, upon satisfying the obligation of the principal, is entitled to seek contribution from co-sureties but is silent as to the issue of subrogation as to a secondary obligor. See Cal. Civ. Code § 2848 (West 1993). However, California case law has permitted subrogation in this instance. See, e.g., Pond v. Dougherty, 6 Cal. App. 686, 688-89, 92 P. 1035, 1036 (1907) ("A surety who is compelled to pay the debt of the principal is entitled to be subrogated to all the rights and remedies of the creditor as against his co-sureties in precisely the same manner as against the principal debtor").

Paragraph (1)(d)

Accord: "The surety may be subrogated to any causes of action either the creditor or the debtor has against third parties responsible for the loss." Regents of Univ. of Cal. v. Hartford Accident & Indem. Co., 21 Cal. 3d 624, 638 n.6, 581 P.2d 197, 204 n.6, 147 Cal. Rptr. 486, 493 n.6 (1978).

Paragraph (2)

Accord: See Williams v. Riehl, 127 Cal. 365, 372, 59 P. 762, 765 (1899), which held that secondary obligor assignees to the rights of obligee were entitled to recover from cosureties the amount the cosureties were liable for in "the proportion of the respective amounts or penalties for which they became surety."

**Section 29 - Secondary Obligor Succeeds to Priority Status of Obligee**

Accord: The secondary obligor's right to subrogation goes back to the date of the contract of suretyship, and takes priority over any assignment made subsequent to such contract but prior to payment of the principal obligation. County of San Diego v. Crogh, 2 Cal. App. 2d 494, 500, 38 P.2d 474 (1934); see also In re Charles Nelson Co., 29 F. Supp. 56 (N.D. Cal. 1939) (under California law, a secondary obligor who pays the principal's debt is subrogated to all the creditor's rights and priorities).

**Section 30 - Secondary Obligor Succeeds to Obligee's Freedom from Defenses**

No relevant California authority.

**Section 31 - Secondary Obligor's Right to Return Performance; Obligee's Right of Set-Off**



No relevant California authority.

## **Section 32 - Effect of Suretyship Status on Duties of Secondary Obligor and Obligee; Undisclosed Suretyship Status and Change in Relationship of Parties**

### Paragraph (1)

Accord: Section 2837 of the California Civil Code states that in interpreting the terms of a contract of suretyship, the same rules are to be observed as in the case of other contracts. Cal. Civ. Code § 2837 (West 1993); see RCA Corp. v. Hunt, 133 Cal. App. 3d 903, 906, 84 Cal. Rptr. 633, 634 (1982) (holding that the suretyship contract is to be construed as any other type of contract, giving effect to the intent and purpose of the parties to such contract); see also Airlines Reporting Corp. v. U.S. Fidelity & Guar. Co., 31 Cal. App. 4th 1458, 1461, 37 Cal. Rptr. 2d 563, 565 (1995) (same); Kalfountzos v. Hartford Fire Ins. Co., 37 Cal. App. 4th 1655, 1658, 44 Cal. Rptr. 2d 714, 715-16 (1995) (holding that the defenses of the principal are available to the secondary obligor). For further discussion see annotations to sections 37 through 49.

### Paragraphs (2) and (3)(a)

Accord: Section 2832 of the California Civil Code provides:

One who appears to be a principal, whether by the terms of a written instrument or otherwise, may show that he is in fact a secondary obligor, except as against persons who have acted on the faith of his apparent character of principal. It is not necessary for him to show that the creditor accepted him as secondary obligor.

Cal. Civ. Code § 2832 (West 1993).

### Paragraph (3)(a)

Accord: See Cal. Civ. Code § 2832 (West 1993); see also Cal. Civ. Code § 2788 (West 1993) (providing that a person may become a secondary obligor even without the consent of the principal); Westinghouse Credit Corp. v. Wolfer, 10 Cal. App. 3d 63, 67-68, 88 Cal. Rptr. 654, 656-7 (1970) (wherein the creditor's failure to recognize the suretyship relationship between the debtor and a third person and such creditor's subsequent extension of time for payment gave rise to a meritorious defense of the debtor when sued by the creditor on the obligation).

### Paragraph (3)(b)

No relevant California authority.

### **Section 33 - Secondary Obligor's Collateral Available to Obligee**

Accord: Section 2854 of the California Civil Code provides that a creditor is entitled to the benefit of everything a secondary obligor has received from the debtor by way of security for the performance of the debtor's obligation to the secondary obligor. Cal. Civ. Code § 2854 (West 1993).

### **Section 34 - When Defenses of Principal Obligor May Be Raised by Secondary Obligor as Defenses to Secondary Obligation**

General Comment to Sections 34-49: Sections 34-49 relate to defenses of or exoneration of the secondary obligor. As set forth in the annotations below, the Restatement of Suretyship and California law provide similar reasons why a secondary obligor may have defenses or be exonerated. The Restatement of Suretyship provides that in most instances "fundamental" alterations in the risks imposed on a secondary obligor result in the discharge of the secondary obligor, as is the case under California law, although less than "fundamental" alterations in such risks may also exonerate a secondary obligor under California law. Although the reasons for exoneration under California law and the Restatement of Suretyship may be similar, the California Civil Code provides for full exoneration in many instances, while the Restatement of Suretyship provides that the principal obligor loses its right to enforce the obligations of the secondary obligor only to the extent of the loss caused to the secondary obligor by the creditor's action. On the other hand, Division 3 of the California Commercial Code (Negotiable Instruments) adopts an approach in several instances that is similar to the more limited exoneration provided in the Restatement of Suretyship. See Cal. Com. Code § 3117 (West) ("To the extent an obligation is modified, supplemented or nullified by an agreement under this section, the agreement is a defense to the obligation."); see annotations to section 37, paragraphs 4(a) and (b); but see Cal. Civ. Code § 2819 (West Supp. 1999) (when creditor alters the original obligation of the principal or the rights and remedies of the creditor against the principal, without consent of the secondary obligor, the secondary obligor is exonerated.); see annotations to section 37, paragraphs 1 and 3.

#### Paragraph (1)

Accord: Generally, in California, a secondary obligor has a right to avail itself of any defense that would be allowed the principal. See Fricklinger v. Swedlow Eng'g Co., 45 Cal. 2d 388, 394, 289 P.2d 214, 218 (1955); U.S. Leasing Corp. v. du Pont, 69 Cal. 2d 275, 290, 444 P.2d 65, 75, 70 Cal. Rptr. 393, 403 (1968) (if a principal obligor is not liable on an obligation neither is the secondary obligor); but see Regents of Univ. of Cal. v. Hartford Accident & Indem. Co., 21 Cal. 3d 624, 636, 581 P.2d 197, 203, 147 Cal. Rptr. 486, 492 (1978) (obligation of secondary obligor remains notwithstanding the fact that the statute of limitations has run on the obligation to the principal).

Paragraph (1)(a)

Accord: See Cal. Civ. Code § 2825 (West 1993) (a secondary obligor is not exonerated by the discharge of the principal by operation of law, without the intervention or omission of the creditor); and Regents of the Univ. of Cal. v. Hartford Accident & Idem. Co., 21 Cal. 3d 624, 643, 581 P.2d 197, 208, 147 Cal. Rptr. 486, 497 (dictum recognizing the public policy against the bankruptcy of a principal exonerating a secondary obligor).

Note: California Civil Code sections 3225 and 3226 deprive one class of secondary obligors (i.e. issuers of bonds in favor of public entities) of any defenses that might otherwise excuse performance. Cal. Civ. Code §§ 3225, 3226 (West 1993).

Paragraph (1)(b)

Accord: Section 2810 of the California Civil Code additionally provides, "any mere personal disability of the principal, though the disability be such as to make the contract void against the principal, will not relieve the surety of liability." Cal. Civ. Code §§ 2810, 3225, 3226 (West 1993); see Parrish v. Rosebud Min. & Mill. Co., 71 P. 694, 695, 7 Cal. Unrep. 117, 121 (1903) ("if the supposed principal obligation be void from any cause other than that of personal disability of the principal obligor, the guaranty is also of no validity").

Paragraph (2)

Accord: Section 2810 of the California Civil provides:

Where the principal is not liable because of mere personal disability, recovery back by the creditor of any res which formed all or part of the consideration for the contract shall have the effect upon the liability of the secondary obligor which is attributed to the recovery back of such a res under the law of sales generally.

Cal. Civ. Code § 2810 (West 1993).

Paragraph (3)

See annotations to sections 37 through 49.

**Section 35 - When Principal Obligor's Claim Against Obligee May Be Utilized by Secondary Obligor to Reduce Secondary Obligation**

No relevant California authority.

## **Section 36 - Right of Secondary Obligor to Set Off Claim Against Obligor Against Secondary Obligation**

Accord: As the Comment to this section notes, the rule is an application of the general rule of setoff. Under California law, counterclaims are authorized to be filed as cross-complaints. See Cal. Code Civ. Proc. § 428.80 (West 1973). Also, a defendant has a right to assert a pre-existing cross-demand for money as a defense. See Cal. Code Civ. Proc. § 431.70 (West Supp. 1999). see Kruger v. Wells Fargo Bank, 11 Cal. 3d 352, 521 P.2d 441, 113 Cal. Rptr. 449 (1974) (general right of setoff).

## **Section 37 - Impairment of Suretyship Status**

### Paragraph (1)

Accord: Under California law, a secondary obligor may be discharged if the obligee alters the obligation of the principal obligor or impairs the remedies or rights of the obligee against the principal obligor without the consent of the secondary obligor. See Cal. Civ. Code § 2819 (West Supp. 1999). See also Roberts v. Security Trust & Sav. Bank, 196 Cal. 557, 238 P. 673 (1925); United States v. Freel, 186 U.S. 309, 22 S. Ct. 875 (1902) (in both cases material alteration of original obligation without secondary obligor's consent discharged secondary obligor). The discharge of the secondary obligor is generally not limited to the loss incurred as a result of such alteration or impairment. See annotations to paragraph (3).

### Paragraph (2)

Accord: Fundamental alteration in the risks imposed on the secondary obligor without the secondary obligor's consent will exonerate the secondary obligor under California law, but such exoneration may also occur when the obligation of the principal obligor or the remedies or rights of the obligee against the principal obligor are altered in any respect, regardless of whether the alteration in the risks imposed is fundamental. See Cal. Civ. Code § 2819 (West Supp. 1999).

### Paragraph (2)(a)

Other: A secondary obligor who has been indemnified by the principal obligor will remain liable with respect to the obligation of the principal obligor, notwithstanding the modification of the obligation or the release of the principal obligor by the obligee without the consent of the secondary obligor. See Cal. Civ. Code § 2824 (West 1993). However, a mere agreement to indemnify by the principal obligor is not sufficient; the secondary obligor must have received "the indemnified amount, physical collateral or a lien on property." Texaco Ref. & Mktg., Inc. v. Aetna

Casualty & Sur. Co., 895 F.2d 637, 640 (9th Cir. 1990) (applying California law and quoting with approval an excerpt of the record of the district court).

Paragraph (2)(b)

Accord: See annotation to section 41(b)(i).

Paragraph (3)(a)

Contra: Under California law, an agreement by the obligee to accept from the principal obligor less than the balance owed on the obligation without the consent of the secondary obligor will not discharge the secondary obligor for the difference between the principal obligation and the amount accepted. See Cal. Civ. Code § 2822(b) (West Supp. 1999). Similarly, the discharge of an obligation of a party to pay a negotiable instrument does not discharge the obligation of an indorser or accommodation party having the right of recourse against the discharged party. See Cal. Com. Code § 3605(b) (West Supp. 1999); see also Cal. Com. Code § 3605 comment 3 (West Supp. 1999) (noting that allowing a creditor to settle with the principal debtor is in the interest of secondary obligors as well as the creditor).

Paragraph (3)(b)

Accord: Under California law with respect to secondary obligors generally, an extension of the time for performance of the obligation of the principal obligor without the consent of the secondary obligor constitutes a material alteration, which results in the discharge of the secondary obligor, but such discharge is not limited to the loss incurred by the secondary obligor as a result of such extension. See Cal. Civ. Code § 2819 (West Supp. 1999); see also Daneri v. Gazzola, 139 Cal. 416, 418, 73 P. 179, 180 (1903) (extension of time of payment of note, among other things, exonerated secondary obligor); State Board of Equalization v. Carleton, 223 Cal. App. 3d 1607, 1610, 273 Cal. Rptr. 436, 438 (1990) (stating that an agreement to extend time can be deemed a material alteration that operates to discharge the secondary obligor, but holding that the secondary obligor consented to the alteration).

An extension of the due date of a negotiable instrument discharges an indorser or accommodation party having a right of recourse against the party whose obligation was extended only to the extent that such indorser or accommodation party proves that the extension caused loss with respect to its right of recourse. See Cal. Com. Code § 3605(c) (West Supp. 1999); see also annotation to section 49.

### Paragraph (3)(c)

Accord: A material alteration of the obligation of the principal obligor without the consent of the secondary obligor will generally discharge the secondary obligor irrespective of whether the alteration was prejudicial to the secondary obligor. See Cal. Civ. Code § 2819 (West 1993 & Supp. 1999); see also Verdugo Highlands, Inc. v. Security Ins. Co. of New Haven, 240 Cal. App. 2d 527, 530, 49 Cal. Rptr. 736, 739 (1966); ITT Diversified Credit Corp. v. Highlands Ins. Co., 191 Cal. App. 3d 301, 306, 236 Cal. Rptr. 433, 436 (1987).

A material modification of a negotiable instrument completely discharges the obligation of an indorser or accommodation party except to the extent the obligee proves that the indorser or accommodation party did not suffer loss. See Cal. Com. Code § 3605(d) (West Supp. 1999).

### Paragraph (3)(d)

Accord: Under California law, release of the collateral securing the obligation of the principal obligor will generally result in full exoneration of the secondary obligor. See Massachusetts Bonding & Ins. Co. v. Osborne, 233 Cal. App. 2d 648, 663-64, 43 Cal. Rptr. 761, 771 (1965); Wexler v. McLucas, 48 Cal. App. 3d Supp. 9, 14, 121 Cal. Rptr. 453, 456 (1975). See also annotation to section 42, regarding the discharge of a secondary obligor upon a disposition of collateral that does not comply with the requirements of Division 9 of the California Commercial Code.

If the obligation of a party under a negotiable instrument is secured by collateral and the person entitled to enforce such negotiable instrument impairs the value of such collateral, the obligation of an indorser or accommodation party is discharged to the extent of the impairment. See Cal. Com. Code § 3605(e) (West Supp. 1999); see also In re Alcock, 50 F.3d 1456, 1460 (9th Cir. 1995) (applying California law).

### Paragraph (3)(e)

Contra: California has adopted the rule that the secondary obligor is not discharged by the expiration of the statute of limitations against the principal obligor. See, e.g., Regents of Univ. of Calif. v. Hartford Accident & Indem. Co., 21 Cal. 3d 624, 639, 501 P.2d 197, 206, 147 Cal. Rptr. 486, 495 (1978) (the failure of the creditor to file suit against the principal within the period of the applicable statute of limitations does not exonerate the secondary obligor, but the court's holding relied in part on the former Restatement of the Law of Security).

### Paragraph (3)(f)

Accord: Under California law, impairment of the right of recourse against the principal obligor will result in the complete exoneration of the secondary obligor. See, e.g., Union Bank v. Gradsky, 265 Cal. App. 2d 40, 41, 71 Cal. Rptr. 64, 69 (1968) (holding that the creditor was estopped from pursuing the secondary obligor for a deficiency after the creditor sold property of the principal debtor subject to a trust deed in a nonjudicial foreclosure sale that prevented the secondary obligor from obtaining a deficiency judgment against the principal debtor).

### Paragraph (4)(a) and (b)

Contra: A secondary obligor, as a person entitled to receive notification of any disposition of collateral under Division 9 of the California Commercial Code, has a right to recover from the secured party any loss caused by the failure of such disposition to comply with the provisions of that division. See Cal. Com. Code § 9507(1) (West 1990). See U.C.C. § 9-618 (1998) (a secondary obligor acquires the rights of the secured party upon an assignment of a secured obligation, a transfer of collateral or subrogation to the rights of the secured party).

## **Section 38 - Preservation of Secondary Obligor's Recourse**

### Paragraphs (1) and (2)

No relevant California authority.

## **Section 39 - Release of Underlying Obligation**

### Paragraph (a)

Accord: California Code of Civil Procedure section 877(b) provides that a release given before judgment to one or more co-obligors mutually subject to contribution rights discharges the released party from liability for contribution to any other co-obligors. Cal. Civ. Proc. Code § 877(b) (West Supp. 1999).

### Paragraph (b)

Accord: A discharge of a secondary obligor was effected where the principal obligor was no longer required to assign invoices to obligee. See Texaco Ref. & Mktg., Inc. v. Aetna Casualty & Sur. Co., 895 F.2d 637, 640 (9th Cir. 1990) (applying California law); Cal. Civ. Code § 2819 (West Supp. 1999).

Paragraph (b)(i)

No relevant California authority.

Paragraph (b)(ii)

Contra: Without the consent of the secondary obligor, the intention of the obligee to retain its claim against the secondary obligor would not be sufficient to preserve such a claim. See Cal. Civ. Code § 2819 (West Supp. 1999). One court has, however, found implied consent when a change in the principal obligation was done for the benefit of the secondary obligor. See Fruit Growers Supply Co. v. Goss, 4 Cal. App. 2d 651, 41 P.2d 357 (1935).

Paragraph (c)(i)

Accord: Section 2822 of the California Civil Code provides that the acceptance by a creditor of anything in partial satisfaction of an obligation reduces the obligation of a secondary obligor in the same measure as that of the principal, but does not otherwise affect it. Cal. Civ. Code § 2822 (West Supp. 1999); Cal. Civ. Code § 2822 (West Supp. 1999); see also T&R Painting Constr., Inc. v. St. Paul Fire & Marine Ins. Co., 23 Cal. App. 4th 738, 29 Cal. Rptr. 2d 199 (1994).

Paragraph (c)(ii)

Contra: Under California law, an agreement by the obligee to accept from the principal obligor less than the balance owed on the obligation without the consent of the secondary obligor will not exonerate the secondary obligor for the lesser sum agreed upon by the obligee and the principal obligor. See Cal. Civ. Code § 2822(b) (West Supp. 1999).

Accord: The discharge of an obligation of a party obligated to pay a negotiable instrument does not discharge the obligation of an indorser or accommodation party having the right of recourse against the discharged party. See Cal. Com. Code § 3605(b) (West Supp. 1999); see also Cal. Com. Code § 3605 comment 3 (West Supp. 1999) (noting that the release of the borrower on its note does not affect the right of the accommodation party to obtain reimbursement from the borrower or to enforce the note against the borrower if the accommodation party has paid the amount due on the note).



#### Paragraph (c)(iii)

Contra: A release of a material duty of the principal obligor will effect an exoneration of the secondary obligor. See Cal. Civ. Code § 2819 (West Supp. 1999).

#### Paragraph (d)

No relevant California authority.

### **Section 40 - Extension of Time**

#### Paragraph (a)

Contra: Under California law, an extension of time for a definite term serves as a material change to the underlying obligation and therefore will generally discharge a secondary obligor: "[A]n extension of time of payment without the consent of the surety constitutes a material alteration of the original obligation and discharges the surety." Wise v. Clapper, 257 Cal. App. 2d 770, 774, 65 Cal. Rptr. 231, 233 (1968); see also Daneri v. Gazzola, 139 Cal. 416, 418, 73 P. 179, 180 (1903) (extension of time with respect to the principal obligation, among other things, exonerated secondary obligor); State Board of Equalization v. Carleton, 223 Cal. App. 3d 1607, 1610, 273 Cal. Rptr. 436, 438 (1990) (stating that an agreement to extend time is deemed a material alteration that causes the discharge of the secondary obligor, although court found that the secondary obligor had consented to such alteration).

#### Paragraph (b)

Accord: See Cal. Com. Code § 3605(c) (West Supp. 1999) (with respect to indorsers and accommodation parties regarding negotiable instruments). See annotation to section 40(a). Note, however, that California law generally contemplates a complete discharge of the secondary obligor, while the Restatement of Suretyship provides a discharge only to the extent that the secondary obligor has suffered a loss.

#### Paragraph (c)

Contra: See annotation in section 40(a). California law does not address changes (other than a complete discharge) in the scope of the duties owing by the secondary obligor regarding the secondary obligation because of the general rule of complete discharge of the secondary obligation, as noted above.

Paragraph (d)

No relevant California authority.

**Section 41 - Modification of Underlying Obligation**

Paragraph (a)

No relevant California authority.

Paragraph (b)(i)

Accord: Material alterations of the principal obligation may result in the exoneration of the secondary obligor. See ITT Diversified Credit Corp. v. Highlands Ins. Co., 191 Cal. App. 3d 301, 236 Cal. Rptr. 433 (1987); Texaco Ref. & Mktg., Inc. v. Aetna Casualty & Sur. Co., 895 F.2d 637 (9th Cir. 1990) (applying California law). California applies a much broader discharge rule, which exonerates a secondary obligor in the absence of consent when the underlying obligation is materially altered by the obligee. See Cal. Civ. Code § 2819 (West Supp. 1999). See general comment to sections 34-49.

Contra: Section 2824 of the California Civil Code provides that alterations in the risks imposed on secondary obligors that otherwise would effect an exoneration will not do so if the principal obligor has indemnified the secondary obligor. Cal. Civ. Code § 2824 (West 1993). Such an indemnity must be greater than a mere agreement to provide an indemnity; the secondary obligor must have received " 'the indemnified amount, the physical collateral or a lien on property.' " Texaco Ref. & Mktg., Inc. v. Aetna Casualty & Sur. Co., 895 F.2d 637, 640 (9th Cir. 1990) (applying California law) (quoting with approval the district court record).

Paragraph (b)(ii)

Accord: Modifications of the duties of the principal obligor not of a fundamental nature may nevertheless result in the exoneration of the secondary obligor under section 2819 of the California Civil Code. See Cal. Civ. Code § 2819 (West Supp. 1999). Such modifications must generally be of a material nature. See Verdugo Highlands, Inc. v. Security Ins. Co., 240 Cal. App. 2d 527, 49 Cal. Rptr. 736 (1966); ITT Diversified Credit Corp. v. Highlands Ins. Co., 191 Cal. App. 3d 301, 236 Cal. Rptr. 433 (1987). Further, such modifications are not required to be of a prejudicial nature in order to effect the exoneration of the secondary obligor. See Hill & Morton v. Coughlan, 214 Cal. App. 2d 545, 29 Cal. Rptr. 550 (1963). California law varies from the Restatement with respect to the extent of the measure of relief afforded a secondary obligor; however, under the

applicable circumstances section 2824 of the California Civil Code provides that alterations in the risks imposed on secondary obligors that otherwise would effect an exoneration will not do so if the principal obligor has indemnified the secondary obligor. Cal. Civ. Code § 2824 (West 1993). Such an indemnity must be greater than a mere agreement to provide an indemnity; the secondary obligor must have received "the indemnified amount, the physical collateral or a lien on property." Texaco Ref. & Mktg. Inc. v. Aetna Casualty & Sur. Co., Inc., 895 F.2d 637, 640 (9th Cir. 1990) (applying California law) (quoting with approval the district court record).

#### Paragraph (c)(i)

Contra: Generally, a material modification of the principal obligation will exonerate a secondary obligor (see comments to subsection (b) and above). The instance where the secondary obligation is modified (part payment) is excluded from the scope of this section (see comments to section 39 above regarding section 2822 of the California Civil Code regarding partial payment).

#### Paragraph (c)(ii)

Contra: Generally, a material modification of the principal obligation will exonerate a secondary obligor; see comments to subsection (b) above. As California law does not generally contemplate the situation where material modifications of the underlying obligation do not exonerate the secondary obligor, the assumptions underlying the rule in this subsection are not directly applicable in California.

#### Paragraph (d)

No relevant California authority.

### **Section 42 - Impairment of Collateral**

#### Paragraph (1)

Accord: The California Civil Code and the Restatement of Suretyship agree that a secondary obligor may be discharged if the obligee impairs the collateral securing an underlying obligation; the Restatement of Suretyship differs in that it discharges the secondary obligor only to the extent of the impairment. See general comment to sections 34-49. Pursuant to the California Civil Code, a secondary obligor is entitled to the benefit of every security for the performance of the principal obligation held by the principal obligor, or by a co-surety at the time of entering into the contract of suretyship or acquired by the principal obligee or co-surety afterwards,

whether the secondary obligor was aware of the suretyship or not. Cal. Civ. Code § 2849 (West 1993). Impairment of the rights set forth in section 2849 of the California Civil Code results in the exoneration of the secondary obligor entirely: "By releasing the security, the [obligee] has also released the surety." Wexler v. McLucas, 48 Cal. App. 3d Supp. 9, 14, 121 Cal. Rptr. 453 (1975); see also Massachusetts Bonding & Ins. Co. v. Osborne, 233 Cal. App. 2d 648, 43 Cal. Rptr. 761 (1965). Please note that this section of the Restatement of Suretyship and California law are inconsistent regarding the measure of relief afforded a secondary obligor when an impairment of collateral occurs.

Paragraphs (2)(a) -- (2)(c)

Accord: See Cal. Com. Code § 3605 (e), (f) (West Supp. 1999); see also Alcock v. SBA (In re Alcock), 50 F.3d 1456 (9th Cir. 1995) (applying California law).

Paragraph (2)(d)

Accord: See Cal. Com. Code § 3605 (e), (f) (West Supp. 1999); see also Alcock v. SBA (In re Alcock), 50 F.3d 1456 (9th Cir. 1995) (applying California law). Intermediate appellate authorities applying California law have treated secondary obligors as having the rights of "debtors" under the California Commercial Code with respect to notices and the requirement of commercial reasonableness in the disposition of collateral thereunder. Sections 9610 and 9611 of Revised Division 9 provide guidelines for the disposition of collateral and the notification requirements thereof for persons including debtors. In the absence of an enforceable, pre-default waiver by a secondary obligor (which is problematic under California Commercial Code section 9501(3)), under section 9504(c) of the California Commercial Code, failure of the obligee-secured party to effect a disposition of collateral in compliance with the specified conditions of section 9504(c) would adjust the liability of the principal obligor and the secondary obligor generally in accordance with the precepts of this section of the Restatement of Suretyship. See Cal. Com. Code § 9504 (West Supp. 1999). Section 9507 of the California Commercial Code also provides a debtor or other person entitled to notice (which includes a secondary obligor) the right to recover a loss from the obligee. See Cal. Com. Code § 9507 (West 1964). See annotation to Section 48.

Contra: Section 9504(b) and section 9504(d) of the California Commercial Code provide for the complete discharge of the debtor (including the secondary obligor) under the conditions specified therein. Cal. Comm. Code § 9504(b), (d) (West Supp. 1999).

### **Section 43 - Delay in Enforcement; Running of the Statute of Limitations as to Underlying Obligation**

Contra: California has generally adopted the rule that the secondary obligor is not discharged by the expiration of the statute of limitations against the principal obligor. See, e.g., Bloom v. Bender, 48 Cal. 2d 793, 313 P.2d 568, (1957) ("[I]n California, the obligation of surety on the continuing obligation is not barred merely because the statute of limitations had run against the obligation of the principal obligor.").

### **Section 44 - Other Impairment of Recourse**

Accord: Under California law, impairment of recourse that would cause a secondary obligor a loss may result in the exoneration of the secondary obligor. See, e.g., Union Bank v. Gradsky, 265 Cal. App. 2d 40, 41, 71 Cal. Rptr. 64, 65 (1968) (after default by principal obligor on primary obligation, obligee sold, at a non-judicial foreclosure sale, real property of the principal obligor that was the subject of a trust deed in favor of the obligee. Thereafter, obligee brought suit against secondary obligor to recover a deficiency judgment. The obligee was estopped from obtaining a deficiency judgment against the secondary obligor under such circumstances because the obligee had destroyed its own right, as well as the right of the secondary obligor, to obtain a deficiency from the principal obligor in accordance with section 580d of the California Code of Civil Procedure.); see also Commonwealth Mortgage Assurance Co. v. Superior Court, 211 Cal. App. 3d 508, 259 Cal. Rptr. 425 (1989). While impairment of recourse under this section of the Restatement of Suretyship also results in a discharge of the secondary obligor, the extent of the discharge is not necessarily complete, but rather is based on the nature of the impairment as is more fully set forth in this section.

### **Section 45 - Secondary Obligation of Seller of Right to Collect Money**

Other: Although California law does not address directly the issues that this section addresses, secondary obligors generally have the rights of a debtor with respect to the disposition of collateral under Division 9 of the California Commercial Code. See annotation to section 42.

### **Section 46 - Tender of Performance**

Accord: Section 2839 of the California Civil Code states that performance of the principal obligation, or an offer of such performance, duly made as provided in the Code, exonerates a secondary obligor. Cal. Civ. Code § 2839 (West 1993).

Paragraph (1)(a):

Accord: Daneri v. Gazzola, 139 Cal. 416, 73 P. 179 (1903). Where the principal maker of a note offered to pay, and the payee declined to accept the payment, but granted an extension without the consent of the secondary obligors, the secondary obligors were released. 139 Cal. at 418, 73 P. at 180. Such refusal constituted a "breach of good faith" toward the secondary obligors, and their interests were "imperiled" by the wrongful acts of the creditor. Id. (quoting Curiac v. Packard, 29 Cal. 194, 197 (1865)).

Paragraph (2)(a):

Accord: O'Connor v. Morse, 112 Cal. 31, 44 P. 305 (1896). In an action on a non-negotiable note that was held by plaintiff creditor as collateral security for another obligation, one co-maker paid one-third of the balance on the note and offered to pay the remainder, but the creditor refused to accept the payment. Id. at 36-37, 44 P. at 306. The co-maker who offered to pay was then released from liability to the creditor upon the subsequent insolvency of the remaining co-makers. Id. at 37-38, 44 P. at 307.

**Section 47 - Obligor's Nondisclosure of Events Giving Secondary Obligor Power to Terminate Secondary Obligation**

Accord: Sumitomo Bank of Cal. v. Iwasaki, 70 Cal. 2d 81, 447 P.2d 956, 73 Cal. Rptr. 564 (1968). The court expressly adopted the rule set forth in the Restatement of Security that a creditor owes a duty to secondary obligor to disclose facts known to the creditor if (i) the creditor has reason to believe that (a) those facts materially increase the risk beyond that which the secondary obligor intended to assume, and (b) those facts are unknown to the secondary obligor; and (ii) the creditor has a reasonable opportunity to communicate the facts. 70 Cal. 2d at 90, 447 P.2d at 963, 73 Cal. Rptr. at 571. Failure to disclose such facts to the secondary obligor prior to an extension of further credit to the debtor will discharge the secondary obligor from liability on the subsequent loan if the foregoing conditions are satisfied. 70 Cal. 2d at 93, 447 P.2d at 965, 73 Cal. Rptr. at 573.

**Section 48 - Waiver of Suretyship Defenses; Consent**

Accord: California law has long been consistent with the Restatement of Suretyship rule that a secondary obligor can (1) consent in advance to acts that would otherwise reduce or discharge the secondary obligor's liability, (2) agree that such reductions or discharges will be unavailable to the secondary obligor, and (3) waive the suretyship defenses that would give rise to such reductions or discharges. Citing Restatement of Security section 6 for the proposition that, under the common law, agreements may

waive suretyship defenses, Mead v. Sanwa Bank California, 61 Cal. App. 4th 561, 571, 71 Cal. Rptr. 2d 625, 631 (1998), at footnote 2, stated: "...as the Supreme Court noted long ago [1880] in Harlan v. Ely, it is possible for a surety to bargain away the rights of suretyship and agree with a creditor to be liable as a principal." See also Bloom v. Bender, 48 Cal. 2d 793, 804, 313 P.2d 568 (1957); Union Bank v. Gradsky, 265 Cal. App. 2d 40, 71 Cal. Rptr. 64 (1968); River Bank America v. Diller, 38 Cal. App. 4th 1400, 1413-19, 45 Cal. Rptr. 2d 790 (1995). In addition, some of the statutes that provide suretyship defenses expressly recognize waiver of the protections available thereunder. See, e.g., Cal. Civ. Code § 2819 (West Supp. 1999). Moreover, the California Legislature codified the broad general rule of waivability in Civil Code section 2856 in 1994, and expanded that section in 1996 to further underscore and clarify the ability of a secondary obligor to waive all defenses, whether arising under statutory or common law. Cal. Civ. Code § 2856 (West Supp. 1999).

Consent may be express or implied from the circumstances, and, if express, such consent, agreement or waiver may be effectuated by specific language or by general language indicating the waiver. No particular formula or extraordinary mode of expression is required. See particularly Comments b and d to section 48 of the Restatement of Suretyship. California law is fully in accord. Cal. Civ. Code § 2856. See also Mead v. Sanwa Bank California, 61 Cal. App. 4th 561, 571 n. 2, 71 Cal. Rptr. 2d 625, 631 n.2 (1998).

All three techniques (advance consent, agreement and waiver) for achieving the result of relinquishment of suretyship defenses are permitted and are governed by the same standards. Nevertheless, because of the drafting convention of using express waivers, a few courts sought to apply rules from other areas of law that would require the document creating the secondary obligation to go beyond ordinary contract principles to demonstrate that the waivers were explicit and knowing. See Cathay Bank v. Lee, 14 Cal. App. 4th 1533, 18 Cal. Rptr. 2d 420 (1993). Requiring detailed waivers, explanations of their significance, or separate identification of each ground for discharge would have significantly lengthened most standard form guaranties and probably have rendered them less understandable to most readers. Moreover, such a requirement was inconsistent with the prior trend under California law, which held that no particular form of language is required for an enforceable waiver of suretyship defenses and which tended, under ordinary contract principles, to enforce the intent of the parties as expressed in their agreement. See, e.g., Bloom v. Bender, 48 Cal. 2d 793, 804, 71 Cal. Rptr. 64 (1957); River Bank America v. Diller, 38 Cal. App. 4th 1400, 1413-19, 45 Cal. Rptr. 2d 790 (1995); American Security Bank v. Clarno, 151 Cal. App. 3d 874, 882, 199 Cal. Rptr. 127 (1984); Union Bank v. Ross, 54 Cal. App. 3d 290, 294, 126 Cal. Rptr. 646 (1976); Brunswick Corp. v. Hays, 16 Cal. App. 3d

134, 138-39, 93 Cal. Rptr. 635 (1971); Wiener v. Van Winkle, 273 Cal. App. 2d 774, 786-87, 78 Cal. Rptr. 761 (1969). When the legislature expanded Civil Code section 2856 in 1996, it made clear that any language that expresses an intent to waive suretyship rights and defenses is effective even though it does not include any particular language or phrases or references to statutory provisions or judicial decisions. Cal. Civ. Code § 2856 (West Supp. 1999). The legislature overruled the Cathay Bank case and made clear that California law is fully in accord with the Restatement of Suretyship.

Notwithstanding the above-described broad waivability of suretyship defenses under California suretyship law and under section 48 of the Restatement of Suretyship, one should bear in mind the nonwaivability, before default, of certain rights by those who are secondary obligors supporting an obligation secured by personal property in transactions governed by Division 9 of the California Commercial Code. In these circumstances, the California courts have treated guarantors as "debtors" entitled to the protections afforded under Chapter 5 of Division 9 to debtors after default, including having the benefit of the rule of nonwaivability by debtors of the rights enumerated in California Commercial Code section 9501(3). See, e.g., Hollander v. California Manufacturing Enterprises Inc., 44 Cal. App. 4th 561, 569, 51 Cal. Rptr. 2d 694 (1996); Connolly v. Bank of Sonoma County, 184 Cal. App. 3d 1119, 1125, 229 Cal. Rptr. 396 (1986); C.I.T. Corp. v. Anwright Corp., 191 Cal. App. 3d 1420, 1425-26, 237 Cal. Rptr. 108 (1987). This nonwaivability rule is not an exception to the suretyship law discussed above, as it is a separate body of Division 9 rights (not suretyship rights) that are nonwaivable. To the extent that a particular act by the secured party (who is also the beneficiary of the guaranty) would give rise to both a nonwaivable defense under Division 9 and a waivable suretyship defense, an effective waiver of the suretyship defense does not, of course, waive the defense under Division 9. This subject is dealt with in greater precision by Revised Division 9, which was enacted in California on October 10, 1999, and will become effective July 1, 2001. Rev. Cal. Comm. Code § 9701, Act of October 10, 1999, Ch. 991, § 35, 1999 Cal. Legis. Serv. 5749, 5856-57 (1999). The enumeration of nonwaivable rights under Revised Division 9 is found in Revised Division 9 section 9602; Revised Division 9 section 9624, authorizing certain post-default waivers, provides a limited exception thereto. See also Revised Division 9 section 9628, relieving a secured party from liability and from loss of its right to collect a deficiency when the secured party does not know that a person is a secondary obligor or does not know the person's identity or how to communicate with the person. Revised Division 9 carefully distinguishes among debtors, obligors, and secondary obligors (all three terms are defined in Revised Division 9 section 9102, and Official Comment 2a to that section provides a useful discussion of the



classifications). All secondary obligors within the meaning of Division 9 are secondary obligors within the meaning of the Restatement of Suretyship and as used in this Report, but the reverse is not true.

Paragraph (2):

No relevant California authority.

**Section 49 - Burden of Persuasion With Respect to Impairment of Recourse**

Contra: Section 2837 of the California Civil Code suggests that California law does not distinguish between gratuitous and compensated secondary obligors in regard to the burden of persuasion with respect to impairment of recourse. See Cal. Civ. Code § 2837 (West 1993). Section 3605 of the California Commercial Code, subsections (c), (d), (e) and (f), also establishes different burdens of persuasion depending upon the alleged nature of the impairment. See Cal. Com. Code § 3605 (West Supp. 1999). See also Cal. Com. Code § 3605 comments 3-7; PEB Commentary No. 11, PEB Commentary on the Unif. Com. Code, 3B U.L.A. app. II (February 10, 1994). Note: The distinction drawn by this section in allocating the burden of persuasion is not only between gratuitous and compensated secondary obligors. See Comment b.

**Section 50 - Effect on Secondary Obligation of Obligor's Lack of Action to Enforce Underlying Obligation.**

Paragraph (1)

Accord: Section 2823 of the California Civil Code provides that mere delay by an enforcing creditor will not exonerate a secondary obligor. Cal. Civ. Code § 2823 (West 1993); but note: Humphreys v. Crane, 5 Cal. 173, 175 (1855) (an agreement to extend the time for performance alters the original agreement and may discharge the secondary obligor). See Bridge v. Connecticut Mut. Life Ins. Co., 167 Cal. 774, 782, 141 P. 375, 379 (1914); Shank v. Blackburn, 53 Cal. App. 620, 625, 200 P. 762, 765 (1921). An omission by a creditor, as opposed to mere delay, may discharge the secondary obligor. See Cal. Civ. Code § 2845 (West 1993).

**Section 51 - When Obligor Must First Seek to Collect by Applying Collateral for Underlying Obligation**

Paragraph (1)

Contra: Section 2849 of the Civil Code provides that a secondary obligor is entitled to the benefit of every security for the performance of the principal obligation held by the creditor, or by a cosurety, at the time of entering

into the suretyship contract or acquired by the cosurety, whether the secondary obligor was aware of the security or not. Cal. Civ. Code § 2849 (West 1993); see also Eppinger v. Kendrick, 114 C. 620 (1896) (if the creditor fails to sell the property provided by the debtor, after being instructed to do so, the secondary obligor will be released from its obligation). In Sukut-Coulson, Inc. v. Allied Cannon Co., 85 Cal. App. 3d 648, 654-55, 149 Cal. Rptr. 711, 715-16 (1978), a secondary obligor that did not demand that the obligee pursue other remedies, but rather denied liability, was not entitled to the benefit of section 2849. Section 2845 of the California Civil Code provides that a secondary obligor may require a creditor, subject to section 996.440 of the California Code of Civil Procedure, to proceed against the principal, or to pursue any other remedy in the creditor's power which the secondary obligor cannot pursue, and which would lighten the secondary obligor's burden. Cal. Civ. Code § 2845 (West 1993). Under Everts v. Matteson, 21 C. 3d 437, 132 P. 2d 476 (1942), section 2845 was held to permit a secondary obligor on a real-property secured loan to require the creditor to foreclose on the property before collecting from the secondary obligor. Section 2850 of the California Civil Code provides that a secondary obligor is entitled to have collateral of the principal obligor applied to discharge the obligation before resorting to the collateral of the secondary obligor. Cal. Civ. Code § 2850 (West 1993).

## **Section 52 - Multiple Secondary Obligors - General Principle**

Accord: There is no California authority directly on point, but see section 877 of the California Code of Civil Procedure. Cal. Code Civ. Proc. § 877 (West Supp. 1999) (a release given to one or more co-obligors mutually subject to contribution (such as cosureties) does not discharge any other obligor from liability, but reduces the obligee's claims against the other co-obligors by the amount of the consideration paid for the release or, if greater, the amount stipulated in the release; i.e., amounts received by the obligee from one co-obligor reduce its total claim against the other co-obligors). California Code of Civil Procedure section 877 also provides that such a release discharges the released obligor from liability for contribution to any other co-obligor. Cal Code Civ. Proc. § 877(b) (West Supp. 1999).

## **Section 53 - Distinguishing Cosuretyship From Suretyship**

### **Paragraph (1)**

Accord: In Continental Cas. Co. v. Hartford Accident & Ind. Co., 243 Cal. App. 2d 565, 570-74, 52 Cal. Rptr. 533, 537 (1966), the court stated, "Under some circumstances two persons may be cosureties for the same debt and may

be required to share the loss, even when their liabilities originate in separate contracts. On the other hand, if one of them in equity should bear the ultimate burden rather than the other, they stand in the position of successive sureties." (Citations omitted.)

#### Paragraph (2)

Accord: See Continental Cas. Co. v. Hartford Accident & Indem. Co., 243 Cal. App. 2d 565, 570, 52 Cal. Rptr. 533, 537 (1966) (whether secondary obligors are cosureties or successive secondary obligors depends upon the inferences to be drawn from their contracts and the circumstances of the case). See also Booth v. Friedman, 82 Cal. App. 174, 178-79, 255 P. 222, 224 (1927) (absent agreement of signers, cosureties are proportionately liable for the obligation).

#### Paragraph (3)

Accord: Section 2848 of the California Civil Code provides that a secondary obligor, upon satisfying the obligation of the principal, is entitled to require all cosureties to contribute thereto, without regard to the order in which they became cosureties. Cal. Civ. Code § 2848 (West 1993). In Continental Cas. Co. v. Hartford Accident & Indem. Co., 243 Cal.App. 2d 565, 570-71, 52 Cal. Rptr. 533, 537 (1966) the court stated, "[i]f the first of two successive sureties is forced to pay the debt, he is subrogated to the creditor's rights upon the bond and may enforce it against the second surety."

#### Paragraph (4)

Accord: Continental Cas. Co. v. Hartford Accident & Indem. Co., 243 Cal. App. 2d 565, 52 Cal. Rptr. 533 (1966), holding, on facts substantially similar to those of Illustration 8, that, in equity, the secondary obligor for the subcontractor was a successive secondary obligor, rather than a cosurety, of the secondary obligor for the contractor, and should bear the ultimate burden of the subcontractor's default.

### **Section 54 - Effect of Impairment of Secondary Obligor's Recourse Against Another Secondary Obligor**

Contra: The general rule in California is that release of a cosurety who is jointly and severally liable does not exonerate a secondary obligor. See Cal. Civ. Code § 1543 (West Supp. 1999) (in general, a release of one of two or more joint debtors does not extinguish the obligations of any of the others, unless they are mere secondary obligors of the obligations of the joint debtor released); section 877 of the California Code of Civil Procedure (a release given to one or more co-obligors mutually subject to contribution

(such as cosureties) does not discharge any other co-obligor from liability, but reduces the obligee's claims against the other co-obligors by the amount of the consideration paid for the release or, if greater, the amount stipulated in the release). See Cal. Code Civ. Proc. § 877 (West Supp. 1999); Wristen v. Curtis, 76 Cal. 6, 7, 18 P. 81, 82 (1888); Oil Tool Exchange v. Schuh, 67 Cal. App. 2d 288, 296, 153 P.2d 976, 981 (1945).

## **Section 55 - Rights Between Secondary Obligor - Cosuretyship**

### Paragraph (1)

Accord: See Cal. Civ. Code § 2848 (West 1993); Jackson v. Lacy, 37 Cal. App. 2d 551, 599-60, 100 P.2d 313, 317-18 (1940); Hosking v. Spartan Properties Inc., 275 Cal. App. 2d 152, 157, 79 Cal. Rptr. 893, 896 (1969).

### Paragraph (2):

See generally the annotation to section 54. Under section 2848 of the California Civil Code, a secondary obligor, upon satisfying the obligation of the principal, is entitled to require all of his or her cosureties to contribute thereto, without regard to the order in which they became cosureties. Cal. Civ. Code § 2848 (West 1993); see also Jackson v. Lacy, 37 Cal. App. 2d 551, 559-60, 100 P.2d 313, 317-18 (1940).

### Paragraph (2):

Accord: Compare section 2849 of the California Civil Code (providing, in pertinent part, that a cosurety is entitled to the benefit of every security for the performance of the principal obligation held by a cosurety). Cal. Civ. Code § 2849 (West 1993); see also Williams v. Riehl, 127 Cal. 365, 59 P. 762 (1899) (holding that cosureties who received an assignment of a judgment in exchange for a payment of less than the full amount of the judgment could enforce the assigned judgment against their cosureties only to the extent of their respective contributive shares of the amount paid for the assignment). But, in annotations to section 27, see conflict in California regarding subrogation rights.

## **Section 56 - Cosuretyship - Defenses Against Claim of Cosuretyship**

### Paragraph (1):

See generally the annotation to section 54. See also Overholser v. Glynn, 267 Cal. App. 2d 800, 73 Cal. Rptr. 628 (1968) (holding that a release by one cosurety of rights of contribution against another cosurety does not affect the liability of the non-released cosureties for contribution).

Paragraph (2)

No relevant California authority.

**Section 57 - Cosurety's Contributive Share**

Paragraph (1):

Accord:        See Booth v. Friedman, 82 Cal. App. 174, 178-79, 255 P. 222, 224 (1927).

Paragraph (2)

Accord:        In Williams v. Riehl, 127 Cal. 365, 372, 59 P. 762, 765 (1899), the court noted that the general rule of recovering a proportionate share from all cosureties is altered if any of the cosureties are insolvent, and the burden will be placed on the solvent secondary obligors. But see Alberding v. Brunzell, 601 F.2d 474 (9th Cir. 1979) (Ninth Circuit case appealed from the District Court of Nevada applying California law regarding suretyship issues, in which the court determined that the general rule regarding absent or insolvent cosureties did not apply because the cosureties could have all been sued in a jurisdiction where all cosureties could have been made parties).

**Section 58 - Right of Contributing Cosurety With Respect to Principal Obligor**

Paragraph (1):

Accord:        Williams v. Riehl, 127 Cal. 365, 371, 59 P. 762, 764-765 (1899).

Paragraph (2):

Accord:        Williams v. Reihl, 127 Cal. 365, 59 P. 762 (1899) (the holding of which is consistent with the principles described in comment (e) to this section).

**Section 59 - Rights Between Secondary Obligor - Subsuretyship**

No relevant California authority.

**Section 60 - Subsuretyship - Defenses Against Claim of Subsurety**

No relevant California authority.

**Section 61 - Right of Principal Surety With Respect to Principal Obligor**

No relevant California authority.

## **Section 62 - Accrual of Secondary Obligor's Cause of Action Against Principal Obligor for Reimbursement or Restitution**

Accord: California cases addressing this issue generally focus on the accrual of the cause of action on the date of the secondary obligor's performance. See, e.g., Davies v. Torrance, 188 Cal. 179, 204 P. 820 (1922) (a corporation's indebtedness to the secondary obligors on its note accrues at the time they paid the note); Stone v. Hammell, 83 Cal. 547, 547, 23 P. 703, 703 (1890) (in order for a reimbursement action to accrue, performance of the secondary obligation must satisfy the claim of the obligee and extinguish the debt of the principal obligor to the obligee); Childs v. Stocker-LaBrea Properties, Inc., 9 Cal. App. 3d 276, 279, 88 Cal. Rptr. 34, 36 (1970) (secondary obligor could bring suit against maker of note if and when secondary obligor was required to make good on his guarantee of note). Although no California cases address the situation in which the secondary obligor performed its obligations prior to the date for performance of the underlying obligation, one California court has stated that a secondary obligor is not entitled to reimbursement, contribution or subrogation on account of payments made to the obligee unless it appears that such payments were made under a legal compulsion and not as a mere volunteer. See Schlitz v. Thomas, 61 Cal. App. 635, 638, 216 P. 51, 52 (1923). This requirement, when considered together with the well-settled principle that an obligee's cause of action against a secondary obligor accrues at the same time as the cause of action accrues against the principal obligor, see, e.g., Bloom v. Bender, 48 Cal. 2d 793, 798, 313 P.2d 568, 571 (1957); California First Bank v. Braden, 216 Cal. App. 3d 672, 676, 264 Cal. Rptr. 820, 822 (1989), leads to the conclusion that, under California law, a secondary obligor cannot seek reimbursement or restitution for payments in respect of a secondary obligation until the principal obligation becomes due and payable.

## **Section 63 - Accrual of Cause of Action Against Cosurety or Principal Surety for Reimbursement or Restitution**

### Paragraph (1)

Accord: California cases addressing this issue generally focus on the accrual of the cause of action on the date on which the cosurety's performance first exceeds its contributive share. See, e.g., Hurlbut v. Quigley, 180 Cal. 265, 180 P. 613 (1919) (a cause of action for contribution accrues when one secondary obligor pays more than his share of the principal obligation); Overholser v. Glynn, 267 Cal. App. 2d 800, 806, 73 Cal. Rptr. 628, 631 (1968) (where one of several joint cosureties pays more than a proportionate share of the principal obligation, the cosurety is entitled to obtain a proportionate contribution from those jointly liable); see also Cal. Civ. Code §§ 1432 (West Supp. 1999) and 2848 (West 1993). There are

no California cases that focus on the accrual date described in clause (b) of this section.

Paragraph (2)

No relevant California authority.

**Section 64 - When Statute of Limitations Applicable to Cosurety's or Principal Surety's Cause of Action Against Principal Obligor Begins to Run**

Accord: In Stone v. Hammell, 83 Cal. 547, 23 P. 703 (1890), the California Supreme Court held that where, at the time a paying cosurety received a promissory note from another cosurety as a contribution payment, the statute of limitations had expired on the paying cosurety's cause of action for reimbursement against the principal obligor, the statute of limitations had also expired on the reimbursement claim of the co-surety tendering the promissory note.

**Section 65 - Tolling of Statute of Limitations as to Principal Obligor or Secondary Obligor Ineffective as to Other**

Accord: "It is . . . settled that 'a payment by a principal debtor will not operate to toll the statute of limitations as to a guarantor.'" R.N.C., Inc. v. Tsegeletos, 231 Cal. App. 3d 967, 971, 283 Cal. Rptr. 48, 50 (1991) (quoting Purdy v. Maree, 31 Cal. App. 2d 125, 127, 87 P.2d 390, 391 (1939)).

**Section 66 - Effect of Principal Obligor's Concealment of Default on Statute of Limitations With Respect to Secondary Obligation**

Accord: It is well settled in California that where a party is guilty of fraudulent concealment of a cause of action, the statute of limitations is deemed not to become operative until the aggrieved party discovers the cause of action. See, e.g., Bollinger v. National Fire Ins. Co. of Hartford, Conn., 25 Cal. 2d 399, 411, 154 P.2d 399, 406 (1944); Johnson v. Harcourt, Brace, Jovanovich, Inc., 43 Cal. App. 3d 880, 895, 118 Cal. Rptr. 370, 381 (1974). It is also well settled that an obligee's cause of action against a secondary obligor accrues at the same time as the cause of action against the principal obligor. See, e.g., Bloom v. Bender, 48 Cal. 2d 793, 798, 313 P.2d 568, 571 (1957); California First Bank v. Braden, 216 Cal. App. 3d 672, 676, 264 Cal. Rptr. 820, 822 (1989).

**Section 67 - Preclusive Effect on Secondary Obligor of Litigation Between Obligee and Principal Obligor**

Paragraph (1)

No relevant California authority.

Paragraph (2)

Contra: Unless the secondary obligor, by the terms of its undertaking, agrees to pay or become liable for any judgment obtained against the principal obligor, the secondary obligor is not bound by a judgment obtained in an action against the principal obligor where the secondary obligor is not a party to the record in such action. See Mahana v. Alexander, 88 Cal. App. 111, 122-22, 263 P. 260, 264-65 (1927).

Paragraph (3)

Accord: A default judgment against a principal obligor is not binding on a secondary obligor, including where the principal and secondary obligors are named in the same action. See All Bay Mill & Lumber Co. v. Surety Co., 208 Cal. App. 3d 11, 17-18, 255 Cal. Rptr. 790, 793-94 (1989).

**Section 68 - Preclusive Effect on Principal Obligor of Litigation Between Obligee and Secondary Obligor**

Paragraph (1)

No relevant California authority.

Paragraph (2)

Accord: Section 1912 of the California Code of Civil Procedure codifies this principle ("Whenever, pursuant to [California Code of Civil Procedure §§ 1908 through 1911], a party is bound by a record, and such party stands in the relation of a surety for another, the latter is also bound from the time that he has notice of the action or proceeding, and an opportunity at the surety's request to join in the defense."). Cal. Code Civ. Proc. § 1912 (West 1985). See also Easton v. Boston Inv. Co., 51 Cal. App. 246, 251, 196 P. 796, 798 (1921) (where deed of trust was executed to indemnify secondary obligor against loss or liability arising under the bond, order in bankruptcy proceedings against secondary obligor allowing claim on the bond was not conclusive against grantor of deed of trust in action to foreclose deed of trust by secondary obligor's assignee).

**Section 69 - Third Party Beneficiaries of Secondary Obligor**

Accord: As comment b to section 69 of the Restatement of Suretyship indicates, the application of this section commonly arises in the context of construction contracts. Surety bonds are required to inure to the benefit of



employees, laborers, material suppliers or other persons furnishing services or supplies, see Cal. Civ. Code §§ 3181, 3248 (West 1993 & Supp. 1999). California courts have recognized claims brought by such persons against the secondary obligor that issued the payment bond. See, e.g., Los Angeles Stone Co. v. National Surety Co., 178 Cal. 247, 173 P. 79 (1918); Southern Heaters Corp. v. New York Casualty Co., 120 Cal. App. 2d 377, 260 P.2d 1048 (1953); Pacific States Electric Co. v. U.S. Fidelity & Guaranty Co., 109 Cal. App. 691, 293 P. 812 (1930); see also Cal. Bus. & Prof. Code § 7071.5 (West 1995 & Supp. 1997) (contractor's license bonds); Bonjour, Gough & Stone v. Pacific Employers Ins. Co. (In re Buna Painting & Drywall Co.), 503 F.2d 618 (9th Cir. 1974) (licensing bonds required by California law as a precondition to securing contractor's licenses are essentially third-party beneficiary contracts; the contractor does not have a property interest in the bonds).

## **Section 70 - When Obligation of Secondary Obligor Revives**

No relevant California authority.

## **Section 71 - Legally Mandated Bonds -- Generally**

### Paragraph (1)

Accord: Section 995.020 of the California Code of Civil Procedure provides that the provisions of the Bond and Undertaking Law, California Code of Civil Procedure section 995.010, et seq., apply to a bond or undertaking executed, filed, posted, furnished or otherwise given as security pursuant to any statute of the State of California except to the extent the statute prescribes a different rule or is inconsistent. See Cal. Code Civ. Proc. § 995.020 (West 1999). Section 995.180 of the California Code of Civil Procedure defines "statute" to include administrative regulations promulgated pursuant to statute. See Cal. Code Civ. Proc. § 995.180 (West Supp. 1999). Note: Per California Code of Civil Procedure section 995.020(c), the provisions of the Bond and Undertaking Law do not apply to bail bonds.

### Paragraph (2)

Contra: Section 996.470(b) of the California Code of Civil Procedure provides that if a bond is given in an amount in excess of that required by the statute or order of the court or officer pursuant to statute, the liability of the secondary obligor is reduced to the amount required by statute or order of the court or officer pursuant to statute, unless the excess is the result of a voluntary agreement of the parties to satisfy an objection to the bond under an action or proceeding. See Cal. Code Civ. Proc. § 996.470(b) (West Supp. 1999).

## **Section 72 - Ineligibility of Secondary Obligor on Legally Mandated Bond; Noncompliance with Other Formalities**

Accord: Section 995.380 of the California Code of Civil Procedure provides that if a statutory bond does not contain the substantial matter or conditions required by law for such bond, or there are any defects in the giving or filing thereof, the bond is not void, and the beneficiary may disregard the defect in the bond or its giving or filing, and enforce same against the persons who intended to become and were included as secondary obligors on the bond. See Cal. Code Civ. Proc. § 995.380 (West Supp. 1999).

## **Section 73 - Penalties**

Accord: Section 996.470(a) of the California Code of Civil Procedure provides that notwithstanding the provisions of any other statute, other than Civil Procedure Code section 996.480 respecting payment of costs of enforcement of the bond (including attorneys' fees) and interest on the judgment, the aggregate liability of a secondary obligor to all persons for all breaches of the condition of the bond is limited to the amount of the bond. See Cal. Code Civ. Proc. § 996.470 (a) (West Supp. 1999).

Other: Where a secondary obligor on a bond is a party litigant to the underlying suit against the principal and becomes liable for certain costs as such party litigant, subdivision (a) of California Code of Civil Procedure section 996.470 does not operate to preclude the award of such costs against the secondary obligor. See Harris v. Northwestern National Ins. Co., 6 Cal. App. 4th 1061, 8 Cal. Rptr. 2d 234, 237 (1992). The court in imposing such costs against the secondary obligor in Harris stated that subdivision (a) of California Code of Civil Procedure section 996.470 only deals with liability for a breach of the condition of the bond and does not limit liability of the secondary obligor imposed by statute rather than for a breach of the condition of the bond. The court cited California Code of Civil Procedure section 996.475, which provides that "[n]othing in this chapter is intended to limit the liability of a surety pursuant to any other statute. The section is declaratory of, and not a change, in existing laws." Id. at 1065; Cal. Code Civ. Proc. § 996.470 (West Supp. 1999).

## **Section 74 - Fidelity Coverage**

Accord: In Guardian Fire & Life Assurance Co. v. Thompson, 68 Cal. 208, 9 P. 1 (1885), defendant secondary obligor company provided a bond to plaintiff insurance company to assure payment to plaintiff of sums collected as insurance premiums by plaintiff's local insurance agent. The plaintiff knew that the principal obligor had defrauded plaintiff in the past, but failed to disclose that information. The court stated that continuing the agent in service was equivalent to a declaration that the principal had no

knowledge of the dishonesty of the agent. Accordingly, plaintiff insurance company was denied any collection on the fidelity bond. See also West American Finance Co. v. Pacific Indem. Co., 17 Cal. App. 2d 225, 61 P.2d 963 (1936).